IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

EUROPEAN COMMUNITY, Plaintiff, v. RJR NABISCO, INC., *et al.*, Defendants.	00 Civ. 6617 (NGG/VVP)
DEPARTMENT OF AMAZONAS, *et al.*, Plaintiffs, v. PHILIP MORRIS COMPANIES INC., *et al.*, Defendants.	00 Civ. 2881 (NGG/VVP) 00 Civ. 3857 (NGG/VVP) 00 Civ. 4530 (NGG/VVP) (Consolidated)

PHILIP MORRIS' MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS UNDER RULES 12(b)(1) and (b)(7) THE EUROPEAN COMMUNITY COMPLAINT FOR LACK OF SUBJECT MATTER JURISDICTION AND LACK OF INDISPENSABLE PARTIES

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Defendants Philip Morris Companies Inc., Philip Morris Incorporated, Philip Morris International Inc., Philip Morris Products Inc., and Philip Morris Duty Free, Inc. (collectively "Philip Morris") respectfully submit this memorandum of law in support of their motion under Federal Rules of Civil Procedure 12(b)(1) and (b)(7) to dismiss the Complaint brought by the European Community ("EC") in Case Number 6617 in this consolidated action for lack of subject matter jurisdiction and failure to join indispensable parties, the fifteen member countries of the EC (the "Member States").

INTRODUCTION AND SUMMARY

This action by the European Community seeking to assess and collect customs duties and value-added taxes ("VAT") allegedly owed by third party importers to the EC's fifteen Member States is brought in the *wrong* country, by the *wrong* party, under the *wrong* statute, against the *wrong* parties, and would embroil this Court in contentious political issues that have divided these western European governments since the creation of their single-market economic union more than four decades ago.

Represented by the same American lawyers who are financing the suits by all of the other foreign governmental plaintiffs from Colombia in these consolidated actions, the EC parrots in its Complaint, almost verbatim, the allegations from the Colombian Complaint. The EC Complaint alleges that Philip Morris and other tobacco manufacturers engaged in separate conspiracies to "facilitate" international smuggling of cigarettes in Europe by third parties, purportedly in violation of the treble-damages provisions of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961 *et seq*.[1] The essence of all of these suits is that Philip Morris allegedly had "reason to know" that its products were being smuggled by *others* into foreign countries, and either facilitated their actions or did nothing to stop them. In short, the EC claims that Philip Morris failed to police its customers and its customers' customers when these third-parties allegedly failed to pay customs duties and VAT to the Member States when the products entered the EC.

[1] Philip Morris denies the allegations of the Complaint and will vigorously contest them in the event that the motions to dismiss are denied.

This action is precluded by the universally followed Revenue Rule which, as the Second Circuit has explained, prohibits a sovereign from maintaining "an action in the courts of another state for the collection of a tax claim." *United States v. First Nat'l City Bank*, 321 F.2d 14, 23-24 (2d Cir. 1963), *rev'd on other grounds*, 379 U.S. 378 (1965). As explained in Part I, in nearly 200 years of American jurisprudence, no U.S. court has ever entertained a suit by a foreign sovereign to assess or collect tax revenues allegedly due, but not adjudicated, in the foreign country.

Plaintiffs' counsel well know that this Court is bound to dismiss this action under the Revenue Rule by the long-standing precedents of the Second Circuit, including the holding in *Moore v. Mitchell*, 30 F.2d 600 (2d Cir. 1929), *aff'd*, 281 U.S. 18 (1930). This knowledge is revealed by the fact that, without notice to this Court, plaintiffs' counsel has filed on behalf of the EC an *amicus curiae* brief in the Second Circuit urging it to abandon its precedents and reverse the Honorable Thomas P. McAvoy's well-reasoned adherence to those precedents in *Attorney General of Canada v. RJ Reynolds Tobacco Holdings, Inc.*, 103 F. Supp. 2d 134 (N.D.N.Y. 2000), *appeal docketed*, No. 00-7972 (2d Cir. Aug. 11, 2000) (argument scheduled for no earlier than the week of April 16, 2001). In that case, Judge McAvoy dismissed for lack of subject matter jurisdiction a virtually identical suit by Canada for import duties and taxes for allegedly smuggled cigarettes. The hypocrisy of the EC's *amicus* brief urging the courts of our nation to abrogate the centuries-old Revenue Rule is shown by the fact that every single nation which is a member of the EC follows the Revenue Rule in its own courts. Thus, the courts of every Member State – including, but not limited to, the United Kingdom, France, Germany, Italy, and Spain – would bar, under the Revenue Rule or its equivalent, any tax claims

brought in any such Member State by the United States or any other foreign country, including a fellow Member State. *See Aps v. Frandsen*, 1 W. L. R. 2169 (English Court of Appeal 1999) (Ex. 8).[2] We urge this Court to examine the EC's *amicus* brief, which does not cite a single case – American or European – where a court entertained a suit by a foreign sovereign for unassessed taxes allegedly owed in a foreign country.

As Judge McAvoy also ruled, in addition to being barred by the Revenue Rule, a foreign sovereign has no claim under RICO for tax revenues or law enforcement expenditures because under U.S. Supreme Court and Second Circuit precedents, RICO does not provide any relief for "sovereign injuries." *See, e.g., Hawaii v. Standard Oil Co.*, 405 U.S. 251, 265 (1972); *Town of West Hartford v. Operation Rescue*, 915 F.2d 92, 103-04 (2d Cir. 1990). In a separate, simultaneously filed Defendants' Joint Motion To Dismiss Under Rule 12(b)(6) the Colombian and European Community Complaints For Failure to State a Claim Upon Which Relief Can Be Granted, filed pursuant to Rule 12(b)(6) ("RICO 12(b)(6) Motion"), which is hereby incorporated by reference, defendants have set forth the numerous additional grounds upon which the EC's RICO claims must fail. Those additional grounds, which will not be elaborated in this memorandum, include: (1) RICO does not apply extraterritorially when all of the alleged adverse effects were sustained in foreign countries and when the conduct that is material to the completion of the alleged offending activities occurred abroad; (2) the injuries alleged were not proximately caused by the actions of the defendants; (3) smuggling and tax evasion – even in the United States, much less in foreign countries – were deliberately

[2] References to exhibit numbers are to exhibits attached to the Declaration of Christopher D. Man, dated January 29, 2001, and filed contemporaneously herewith.

excluded by Congress as predicate acts under RICO; and (4) plaintiff has failed to allege a coherent, structured "enterprise" as required by RICO.

As Part II demonstrates, this Court also lacks subject matter jurisdiction because the EC has not suffered any injury in fact from the matters alleged in the Complaint. Therefore, the EC lacks standing and cannot invoke the processes of this Court. *See Friends of the Earth v. Laidlaw Envtl. Servs., Inc.*, 528 U.S. 167, 180-81 (2000). As set forth in detail and documented below, the Member States collect all of the customs duties and VAT at issue in the Complaint. They are then required to remit an amount equal to a portion of those duties and VAT to the EC for the funding of its limited governmental functions. Under the governing treaties, if there is any shortfall in the EC budget – for whatever reason, including the laxness of enforcement by the Member States, a diminution of imports as a result of market conditions, or reduced collections due to smuggling – the Member States are required to make up out of their treasuries (on a *pro rata* basis) any amount of such shortfalls. *See* Council Regulation 1150/2000, of 22 May 2000, Implementing Decision 94/728/EC, Euratom on the System of the European Communities' Own Resources, art. 17, 2000 O.J. (L 130) 8 (hereinafter referred to as "Own Resources Regulation") (Ex. 2); Council Decision 94/728, of 31 October 1994, on the System of the European Communities' Own Resources, 1994 O.J. (L 293) 9 (hereinafter referred to as "Own Resources Decision") (Ex. 3); Court of Auditors' Special Report No. 17/2000 On the Commission's Control of the Reliability and Comparability of the Member States' GNP Data together with the Commission's Replies, 2000 O.J. (C 336) 4 ¶ 7 (hereinafter referred to as "Court of Auditors' GNP Data Report") (Ex. 4). As explained by the EC itself in a Parliamentary Report:

> In the system of Community finance, any shortfall in . . . revenue . . . is in practice compensated by higher payments from the Member States under the so-called "fourth resource," calculated on the basis of national GNP. The cost of transit fraud [i.e., smuggling] to the Community is therefore ultimately borne by the Member States . . . .

Committee of Inquiry into the Community Transit System, *Report on the Community Transit System* § 4.2.1.2 (Feb. 20, 1997) (hereinafter "*EC Parliamentary Report*") (Ex. 5).

Conversely, if there are any surpluses in the EC budget, the Member States are the ultimate beneficiaries in terms of reduced contributions in the following years. Indeed, as the EC's own official budget documents reveal, in each of the four potential damage years (the four years prior to November 3, 2000), the EC had no shortfalls in its budgets, was fully able to fund all of its activities, and reaped surpluses beyond its budgeted expenditures in every one of those years. As the U.S. Supreme Court held in the *Friends of the Earth* case, *supra*, if there is no injury in fact, there is no standing, and there is no lawsuit.

Moreover, the EC has no authority under its own governing treaty to bring any suit of any kind in the United States. Plaintiffs' counsel apparently has attempted to mislead this Court by omitting from its Complaint the most critical language concerning the EC's powers under the EC Treaty. In the Complaint, the plaintiffs' lawyers claim that "[p]ursuant to Article 282 of the Treaty . . . the European Community . . . may be a party to legal proceedings." (Compl. ¶ 6.) What the plaintiffs' lawyers have omitted, however, is that the precise language of Article 282 of the EC Treaty provides that the EC may be a party to legal proceedings for only those suits brought in the courts of a Member State. Even then, the EC does not have the authority to bring suit in these

national courts to collect taxes or customs duties. Because the EC is clearly acting *ultra vires* in bringing this lawsuit, Philip Morris and other defendants have initiated proceedings in the appropriate European court, the Court of First Instance of the European Communities, to annul the decision to file this suit and to require its dismissal.

Notwithstanding its lack of authority to bring this suit in the United States and apparently recognizing that it has suffered no losses itself, the EC purports to be suing "on its own behalf *and on behalf of the Member States it has power to represent.*" (Compl. p. 1 (emphasis added).) As discussed in Part III, because the EC has not suffered any injuries of its own, the EC lacks standing to sue on behalf of *any* of its Member States. *See New York v. Seneci,* 817 F.2d 1015, 1017-18 (2d Cir. 1987); *accord Dillon v. Combs,* 895 F.2d 1175, 1177 (7th Cir. 1990); *see also Town of West Hartford v. Operation Rescue,* 915 F.2d 92, 102 (2d Cir. 1990). The EC "cannot merely litigate as a volunteer the personal claims of its competent [constituents]" where the Member States have the ability to pursue their own claims in their own courts. *Seneci,* 817 F.2d at 1017; *Town of West Hartford,* 915 F.2d at 102.

Indeed, as explained in Part IV, all fifteen of the Member States are indispensable parties and this suit may not proceed without all of them. The Member States collect the customs duties and VAT and then forward an amount equal to a portion of those duties and taxes to the EC. The Member States, not the EC, are responsible for pursuing the importers and merchants who allegedly owe the taxes. *See* Own Resources Regulation, art. 4, 17, 2000 O.J. (L 130) 3, 8 . As noted in recent press clippings, under the active encouragement of the EC, a few Member States have publicly announced that they are contemplating filing their own actions, or joining in this action, for these taxes. (Exs. 6 &

7). If Member States were to bring such actions in their own courts or, in violation of the Revenue Rule, in American courts, Philip Morris would be exposed to multiple liabilities for the same matters. Moreover, these Member States have all of the most critical records, which would be required for any defense against these claims. If they refuse to be parties in their own right, the absent Member States may seek to prevent the defendants from either impleading them or obtaining access to their critical records. Therefore, the absence of all the Member States from this action requires dismissal for lack of indispensable parties. *See Fluent v. Salamanca Indian Lease Auth.*, 928 F.2d 542, 548 (2d Cir. 1991); *Sty-Lite Co. v. Eminent Sportswear, Inc.*, 115 F. Supp. 2d 394, 400 (S.D.N.Y. 2000). This problem will not be solved if a few Member States join in this case; all fifteen Member States are necessary and indispensable parties.[3]

Part V demonstrates that permitting this suit to proceed would embroil this Court in unsolvable political problems that have bedeviled the EC for more than four decades. In early 1997, the EC received an official report on the EC's transit system from a Committee of Inquiry established by the European Parliament in late 1995 to study the causes and to propose remedies for smuggling activities in the EC ("Committee of Inquiry" or "Parliamentary Committee"). After an exhaustive examination, which included extensive testimony at hearings, numerous written submissions, and interviews with authorities in the Member States, the Committee of Inquiry concluded that the most

[3] Of course, any suits by the Member States in this Court would be precluded, just as the EC's suit is precluded, not only by the Revenue Rule and the political question doctrine, but also by all of the principles set forth in defendants' motion under Rule 12(b)(6) to dismiss for failure to state a claim for relief filed contemporaneously herewith. As explained in defendants' RICO Rule 12(b)(6) Motion, "sovereign injuries," such as lost taxes, are not cognizable under RICO; foreign governments are not "persons" that may bring suit under RICO, and RICO does not apply extraterritorially. (*See* RICO Rule 12(b)(6) Motion).

significant causes of the problem were the political failures of the EC and its Member States to eliminate government-sanctioned incentives for smuggling and adopt policies and procedures that would discourage such smuggling. *See EC Parliamentary Report* § 9.1.1.2

The *EC Parliamentary Report* found that the Council of the European Union "did not merely neglect the anti-fraud aspects associated with Single Market legislation, it *actively resisted* measures which would have helped deal with them." *Id*. § 9.4.2.1 (emphasis added). As to the Member States, not only did they reduce customs personnel and resources, but they knowingly provided "large incentives, especially in the form of high excise rates" to make smuggling profitable and enticing. *Id*. § 10.3.3.1. The *EC Parliamentary Report* conceded that these were "political" questions, requiring the Council and the Member States to decide in accordance with their own priorities. *Id*. § 10.3.3.2.

Of special note, and in marked contrast to the allegations in the Complaint, the *EC Parliamentary Report* concluded that "[n]obody has produced any evidence to the committee demonstrating that cigarette manufacturers are actively involved in cigarette smuggling." *Id*. § 6.5.4.1. The Report states that what is needed are major governmental reforms – both by the Member States and by the EC – as itemized in the report. *See id*. § 17. The attached Declaration of Peter Wilmott (Ex. 1) [4], the former EC Director General for Customs and Indirect Taxation, notes that relatively few of the reforms proposed by

[4] In considering a motion for lack of subject matter jurisdiction, a court may consider affidavits and other materials outside the pleadings. *See Makarova v. United States*, 201 F.3d 110, 113 (2d Cir. 2000). The burden is on the plaintiff to allege facts establishing subject matter jurisdiction. *Id*.

the *EC Parliamentary Report* at the beginning of 1997 have been implemented. (Wilmott Decl. ¶ 16.) To the extent that these changes have been made, the reforms have been extremely slow and/or ineffective.

As detailed in Part V, were this Court to entertain this action, it would be required to examine precisely the governmental actions taken by the fifteen Member States prior to 1993 when a single market for the EC was established; the steps each of the individual Member States has taken or deliberately failed to take in the last few years to address its own contraband problems; the reasons for the failure of the Member States and the EC to implement the recommendations that the Parliamentary Committee found essential to reduce smuggling of all products, including cigarettes; and which entity (if any), the EC or the Member States, is authorized in this country to petition our courts to assist in the resolution of legal issues. These issues are critical to the question of causation and they are precisely the kinds of foreign political questions that lead American courts to dismiss claims for lack of jurisdiction. *See, e.g., Occidental of Umm al Qaywayn, Inc. v. A Certain Cargo of Petroleum Laden Aboard the Tanker Dauntless Colocotronis*, 577 F.2d 1196 (5th Cir. 1978). Any proposed resolution of those issues could have far-ranging consequences for American foreign relations with the Member States and the EC.

Finally, in Part VI, Philip Morris explains that principles of comity require dismissal of the EC Complaint. First, deference to the European administrative agencies charged with the collection of customs duties and VAT justifies dismissal. In addition, the European Court of First Instance is considering threshold issues such as the competence of the EC to bring this action. This Court should dismiss this action based on the pendency of the Court of First Instance proceeding.

For all of these reasons, amplified below, Philip Morris urges this Court to dismiss the EC Complaint for lack of subject matter jurisdiction and for failure to join indispensable parties.

BACKGROUND

A. The Parties

1. The EC, Its Limited Authority, and the European Tax Structure

The plaintiff in this action is the European Community. According to its Complaint, the EC "is a governmental body created as a result of collaboration among the majority of the nations of Western Europe, more specifically, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom." (Compl. ¶ 6.) None of the Member States of the EC is a named plaintiff.

The Treaty of Rome, as later amended by other treaties (the "EC Treaty") (Ex. 9)[5], is the governing charter for the EC.[6] The EC Treaty specifically delimits the authority that the signatory Member States have granted to the EC. Contrary to the misleading, truncated description in the Complaint of the authority accorded to the EC by the EC Treaty, the EC is not authorized to file a suit in the United States or in any other

[5] Treaty Establishing the European Community, as last amended by the Treaty of Amsterdam, Nov. 10, 1997, O.J. (C 340) (hereinafter "EC Treaty") (Ex. 9).

[6] Pursuant to Federal Rule of Civil Procedure 44.1, "[t]he court, in determining foreign law, may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence." *See Carlisle Ventures, Inc. v. Banco Espanol de Credito, S.A.*, 176 F.3d 601, 604 (2d Cir. 1999) (in interpreting foreign law a court "may consider any relevant material or source" and its "determination . . . is treated as a question of law") (citing Rule). Furthermore, under this rule, the Court may consider any "affidavits submitted by the parties." *Euromepa S.A. v. R. Esmerian, Inc.*, 154 F.3d 24, 28 n.2 (2d Cir. 1998).

non-Member country. Article 282, which is the provision of the EC Treaty cited in the Complaint allegedly giving the EC authority to bring this suit, states: "In *each of the Member States*, the Community shall enjoy the most extensive legal capacity accorded to legal persons *under their laws*; *it may*, in particular, acquire and dispose of movable and immovable property and may *be a party to legal proceedings*." EC Treaty art. 282 (emphasis added). Yet despite these express limitations, the EC has filed this suit in this U.S. court on its own behalf and purportedly "on behalf of the Member States it has power to represent." (Compl. p. 1.) The Complaint fails to identify which, if any, of these Member States may be included by that statement or by what authority the EC has such alleged power.[7]

The structure, responsibilities and authority of the EC are established expressly and limited by the EC Treaty entered into and executed by the Member States. EC Treaty arts. 5 & 7. According to the principle of "subsidiarity," the EC should not act if the objective can be effectively achieved by action taken at the Member State level. *See* EC Treaty, art. 5 & 7; *see also* Rudolf Dolzer, *Subsidiarity: Toward a New Balance Among the European Community and the Member States*, 42 St. Louis U. L.J. 529 (1998) (emphasizing the importance of the principle of subsidiarity in EC law). Most critically for present purposes, the EC has no tax collection authority or responsibilities. It has no customs service or agents; it does not enforce the tax or customs laws in Europe; and it

[7] The fact that a number of Member States recently have indicated that they may intervene in this suit suggests that these States do not believe that the EC has the authority or ability to represent their sovereign interests in this matter. (*See* Exs. 6 & 7 (press clippings reporting consideration of joining this suit by certain Member States).) The silence of the other Member States concerning their authorization of this suit is ambiguous at best.

has no direct dealings of any kind with private parties, such as importers, wholesalers, or retailers, who are required to pay customs duties and VAT to Member States in Europe. *See* Own Resources Decision, art. 8(1) 1994 O.J. (L 293) 12; Case 110/76, *Pretore di Cento v. X*, 1977 E.C.R. 851, ¶¶ 3, 6 (1977) (Ex. 10); *see also* (Wilmott Decl. ¶ 19). Even within its own court system, the EC could not bring a tax-collection action against a private party. *Pretore di Cento* ¶ 6.

Each of the fifteen Member States administers its own tax laws and the customs responsibilities for the EC in its borders. Each Member State levies, administers, and collects its own VAT on goods that enter its territory. Council Directive 77/388, art. 7(2), 1977 O.J. (L 145) 6, as amended (Ex. 11). The customs duties are established by the Council of the European Union, but are collected by the Member States in which the goods enter the EC. Own Resources Decision, art. 8, 1994 O.J. (L 293) 12. The Member States retain for their own treasuries most of the VAT, paying only a small percentage of those taxes to the EC. *See Financing the European Union/Commission Report on the Operation of the Own Resources System*, European Commission, Directorate General XIX, Budgets, Resources, Outlook for financing, forecasts, and budget guarantees, Brussels, 7 October, 1998, § 1.1, at 4 (hereinafter "Own Resources Report") (Ex. 12). In the past four years, the Member States retained approximately 10% of the customs duties they collected, remitting an amount equal to the remainder of the customs collections to the EC. (*See* Ex. 13).[8]

[8] Own Resources Decision, art 2(3), 1994 O.J. (L 293) 11. As of January 1, 2001, however, the Member States retain the equivalent of 25% of the collected duties. Council Decision 2000/597, of 29 September 2000, on the system of the European Communities' Own Resources, art. 2(3), 2000 O.J. (L 253) 44. (Ex. 13.)

If any private party, such as an importer or distributor, fails to pay VAT or customs duties, the Member State at the point of entry has the exclusive responsibility and authority to assess and collect the taxes. *See* Own Resources Decision, art. 8(1), 1994 O.J. (L 293) 12; *Pretore di Cento* ¶¶ 3, 6. Each Member State has a separate administrative and judicial system, with markedly different procedures, for the assessment, adjudication, and collection of the taxes. *See* Own Resources Regulation, art. 4(1), 2000 O.J. (L 130) 3. Even after a Member State obtains a tax judgment in its own national courts, it may not attempt to execute on that judgment in another Member State, unless there is a bilateral treaty between those Member States. *Aps v. Frandsen*, 1 W.L.R. 2169 (English Court of Appeal 1999). In 1988, the Member States entered into a treaty, the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, that essentially requires each Member State to give full faith and credit to the judgments of courts in other Member States. But, critically, that Convention, preserved the Revenue Rule, by specifically exempting "revenue, customs or administrative matters" from its requirements. Art. 1, 29 I.L.M. 1413, 1418 (1990).

The EC has no tax collection mechanisms. Indeed, the highest EC court, the European Court of Justice, has ruled specifically and repeatedly that "only the Member States and their authorities are empowered to take proceedings before national courts for the purpose of claiming payment of" revenues that are for the ultimate benefit of the EC. *Pretore di Cento* ¶ 6 (emphasis added). The EC does have the authority to sue a Member State, in the European Court of Justice, when it believes that a given Member State has failed to be diligent in enforcing the tax or customs laws. *See., e.g.*, Case 68/88, *Commission v. Hellenic Republic*, 1989 E.C.R. 2965 (1989) (Ex. 14); *see also*

http://europa.eu/int/pol/emu/index_en.htm (last visited January 25, 2001) (listing cases brought by the EC against its Member States over tax collection issues) (Ex. 15). The EC, however, cannot bring an action against a private party to collect allegedly owed taxes.

Under the Own Resources Decision, the EC receives its funds from the Member States from four delineated sources: (1) agricultural duties collected by the Member States; (2) duties for common customs tariffs (import duties) collected by the Member States; (3) a small, denominated portion of the VAT imposed and collected by the Member States (Ex. 16)[9]; and (4) a percentage of the gross national product ("GNP") of each Member State, to the extent that it "fully covers that part of the [EC] budget" not financed from the other three sources. Own Resources Decision, art. 2(1)(d), 1994 O.J. (L 293) 10; Own Resources Regulation, art. 5, 2000 O.J. (L 130) 3. These four elements are referred to as the EC's "own resources" in the regulation and in EC court decisions relating to them.

Each year the EC prepares a budget that forecasts its total required expenditures and projects its expected revenues from the Member States. *See infra* Part II.A. If the first three resources do not appear sufficient to fund the anticipated expenses, the remaining resources are "guaranteed" by the additional contributions by each of the Member States under the fourth "GNP resource." Court of Auditors' Special Report No. 6/98, 1998 O.J. (C 241) 58, 60-61, ¶¶ 2.10, 3.2 (Ex. 17). The EC's official budget documents reveal that there has been no shortfall in any of the last four years. In each of

[9] *See* Council Regulation No. 1553/89, of 29 May 1989, art. 3, 1989 O.J. (L 155) 1 (establishing that VAT resource is calculated based on total net VAT revenue collected by Member States) (Ex. 16).

those years, the EC has operated with a surplus, which was used in the following year to reduce the need to tap the Member States' contribution from the fourth resource. (Exs. 18-21).[10]

2. The Defendant Cigarette Manufacturers

The defendants named in the Complaint are entities affiliated with United States and foreign tobacco companies. The EC places the defendants into two groups and alleges a separate and distinct conspiracy by each group in competition with the other group. The first group of defendants includes entities affiliated with Philip Morris Incorporated, referred to collectively in the Complaint as the "Philip Morris Defendants." (Compl. ¶¶ 16-20.) The second group of defendants includes entities associated with R.J. Reynolds Tobacco Company, referred to collectively in the Complaint as the "RJR Defendants." (Compl. ¶¶ 7-15.)

B. Allegations of the Complaint

The allegations of the Complaint, which are largely copied (and in many paragraphs lifted verbatim) from the Colombian Complaint, are described in detail in Defendants' RICO Rule 12(b)(6) Memorandum. In essence, the EC's Complaint attempts to blame the long-known problem of cigarette smuggling by Europeans in Europe on two large American cigarette manufacturers and their related companies. The EC's Complaint ignores and contradicts the 1997 *EC Parliamentary Report* which states that "[n]obody has produced any evidence to the Committee demonstrating that cigarette

[10] *See* 1999 Revenue and Expenditure Account and Balance Sheet, 2000 O.J. (C 343) 8 (Ex. 18); 1998 Revenue and Expenditure Account and Balance Sheet, 1999 O.J. (C 350) 13 (Ex. 19); 1997 Revenue and Expenditure Account and Balance Sheet, 1998 O.J. (C 350) 13 (Ex. 20); 1996 Revenue and Expenditure Account and Balance Sheet, 1997 O.J. (C 349) 12 (Ex. 21).

manufacturers are actively involved in cigarette smuggling." *See EC Parliamentary Report* § 6.5.4.1.

Although this action and the consolidated Colombian actions span different continents and involve different groups of defendants, the two actions allege exactly the same types of conduct. Essentially, the EC Complaint contends: the Philip Morris and RJR groups of defendants separately, competitively, and lawfully sold cigarettes to various unnamed foreign cigarette distributors. (Compl. ¶¶ 32-33.) These foreign distributors, in turn, sold the cigarettes to various unnamed "smugglers," who, in turn, illicitly transported the cigarettes through various countries in Europe. (*Id*.) Those smugglers then purportedly bypassed the customs officials of various Member States and evaded the obligation to pay taxes to the Member States on the "contraband" cigarettes. (Compl. ¶¶ 39-40.)

The EC Complaint does not allege that Philip Morris smuggled the goods, but merely that it "facilitated" or failed to prevent the illegal activities of unidentified others. Philip Morris allegedly facilitated smuggling, for example, by selling its products to European customers who were rumored to be involved in smuggling activities and by engaging in public relations activities that made it "more difficult" for authorities of the Member States to police the smuggling by others. (Compl. ¶ 33(l).)

C. The EC's Alleged Damages – Lost VAT and Import Duties

The EC claims that the alleged smuggling activities by European smugglers resulted in its sustaining injury of "hundreds of millions of dollars." (Compl. ¶¶ 4, 40.) These alleged damages are the unpaid customs duties and VAT owed to the Member States that the EC claims would have been later transmitted to fund the EC's budget.

In addition to the alleged losses of taxes and duties, the EC seeks injunctive and equitable relief that would force this Court to monitor the defendants' sales of cigarettes to European distributors and the activities of the European distributors for their compliance with the vastly differing laws of the fifteen Member States. The EC also seeks the recoupment of law enforcement expenses that the EC allegedly incurred to "stop smuggling" (Compl. ¶ 40), even though the Member States, and not the EC, are charged with the enforcement of border control and smuggling matters.

D. The Failure of the EC and the Member States to Correct the Well-Documented Structural Deficiencies that Induce and Conceal Smuggling of Many Products in Europe

As demonstrated in the 1997 *EC Parliamentary Report*, and as amplified by the attached Declaration of former EC customs official Peter Wilmott, the EC and its Member States have long known about: (1) the smuggling problems in the newly-created single market in the European Union; (2) political actions by the EC and the Member States that create the incentives for such smuggling and render ineffective the limited enforcement mechanisms that exist; and (3) the political and procedural reforms necessary to deter and detect such smuggling activities in their territories. (Wilmott Decl. ¶¶ 16-27.)

Five years before the EC filed suit, the European Parliament, in December 1995, established a special Committee of Inquiry to examine Europe's long-standing smuggling problems ("Committee of Inquiry" or "EC Parliamentary Committee"). The Committee of Inquiry received evidence from the Member States as well as the Commission and held many hearings, taking testimony from over 65 witnesses from 32 separate organizations.

After a thirteen-month investigation, the Committee issued the *EC Parliamentary Report* in February 1997. *EC Parliamentary Report*, prelim. remarks.[11]

In its Report, the Committee of Inquiry concluded that "[t]he lack of foresight by the Commission in the introduction of the single market, which has been guided by the principles of market liberalization and the abolition of controls rather than those of safeguarding revenue and maintaining the Community's own resources, has led to a crisis within the transit procedure." *Id*. § 4.3.1. The *EC Parliamentary Report* found that the failing transit system, in turn, fosters an environment conducive to smuggling. *Id*. § 5.4.1. The problem results from a combination of several factors, not one of which falls under the control of cigarette manufacturers.

The EC's Committee of Inquiry found that the EC's transit system is "obsolete, error-ridden, fraud-prone and unpoliceable" and facilitates the contraband trade. *Id.* §§ 9.1.1.2, 9.2.1.3. Under the EC's Community Transit System, customs duties, excise taxes and VAT owed on goods originating from a non-Member State or destined for a non-Member State are temporarily suspended while the goods are transported through the EC. *Id*. § 3.1.1.1. According to the *EC Parliamentary Report*, the Community Transit System may have functioned effectively when, in 1968, the System covered only six countries, internal customs borders were in place, and there was little to no East/West trade. In the intervening twenty years, however, the EC has grown to fifteen countries, and, with the fall of the Iron Curtain, the volume of trade has increased dramatically. Furthermore, all

[11] The *EC Parliamentary Report* is not being offered for its truth, and Philip Morris does not vouch for the specific facts and figures relating to smuggling that appear in it. Rather, this exhibit illustrates the types of political questions upon which factual evidence will have to be offered if this litigation proceeds.

internal systemic border checks have been abolished, and the number of customs agents has been drastically reduced. *Id*. §§ 3.2.1.1, 3.2.1.2.

Despite these sweeping changes, the *EC Parliamentary Report* found that the Community Transit System continues to follow the "archaic paper-based procedure" that it used when it was first established. *Id*. §§ 3.3, 3.4.1. The Committee found it remarkable that "[t]he system relies on nineteenth century techniques . . . . applied to late twentieth century trade." *Id.* § 3.3.1.1. The volume of paper is itself overwhelming. Approximately 3,000 customs offices in the EC, with minimal staffing, share the task of processing up to 18 million transit operations per year, *id.* § 3.3.1.2; customs officials "effectively [are] little more than 'postmen.'" *Id*. § 3.3.1.3.

The EC Parliamentary Committee found that with this mass of paper, "[i]t is inevitable that documents will go astray, be sent to the wrong customs office, be lost and misfiled, etc. Anecdotal evidence even exists of forms simply being discarded by drivers unaware of their purpose." *Id*. § 3.3.1.5. Under these circumstances, "it is impossible to carry out any meaningful check on the documents passing through an office, the quantities are such that the mere handling of documents overwhelms customs services already the victims of widespread personnel cuts." *Id*. § 3.3.1.3.

In an attempt to secure payment of customs duties, the Community Transit System relies on a guarantee, which can be called upon in the event that a transit operation is not completed. The guarantor, known as the "principal," is liable to the customs authorities for the total tax and excise payable on the goods. *Id*. § 3.1.2.4. In the case of cigarettes, "the principal is required to provide for each transit operation a specific guarantee covering 100% of the potential liability." *Id*. § 3.1.2.5. If the

transaction is not cleared at the country of destination, then the customs authorities can seek payment of the outstanding taxes from the principal. *Id*. § 4.2.2.2. As the Parliamentary Committee reported, however, the guarantee system allows some Member States to profit at the expense of other States:

> If, for example, goods are illicitly placed on the black market in France, it is the French state which loses revenue. However, if the transit operation began in Denmark, it will generally be the Danish authorities which enforce the guarantee. Thus the Danes collect revenue (at Danish rates) which they would not normally have received, and the French continue to take the loss. To this extent, transit fraud is arguably beneficial to the public purse in countries where operations begin.

Id. § 4.2.1.6. Moreover, this guarantee operates as an insurance system for public revenue and dampens attempts by law enforcement authorities to investigate the persons responsible for the fraud: "Customs administrations and Member States are no longer pursuing the real perpetrators of fraud but have made a collection of duties from freight forwarders a routine procedure . . . ." *Id.* § 7.5.1.1.

The Parliamentary Committee further found that the openness of the internal borders between Member States allows goods simply to "disappear" *en route* to destinations. *Id*. § 5.2.1.1. Although an increase in smuggling was a foreseeable consequence of the removal of customs barriers within the EC, there was no significant reform of the transit system in the race to establish a common market. *Id.* § 9.2.1.3. Instead, "[t]he enthusiasm for an open economy has apparently led to a neglect of the measures required to ensure that the openness of the economy and the ease with which goods could be moved around within the European Union did not render it extremely vulnerable to fraud." *Id*. § 9.2.2.3. Quite simply, the EC made a conscious policy

decision to facilitate free trade at the expense of law enforcement. Indeed, the "Council did not merely neglect the anti-fraud aspects associated with Single Market legislation, it *actively resisted* measures which would have helped deal with them." *Id*. § 9.4.2.1. (emphasis added).

The *EC Parliamentary Report* notes that even though most of the losses are "suffered by the Member States rather than by the European Community budget," the Member States themselves have failed to address the problem. *Id*. § 9.5.4.1. As a political choice, the Member States do not always claim the taxes owed under a guarantee. *Id*. §§ 4.2.2.9, 4.2.2.10, 4.2.2.11. In order to save freight companies from bankruptcy, and to prevent a corresponding rise in unemployment, the collecting Member State often decides not to assert a claim against the guarantor. *Id*.

In addition, the Parliamentary Committee found that the EC and its Member States encourage contraband "by providing large incentives, especially in the form of high excise rates." *Id.* § 10.3.3.1. This issue, however, stands firmly as a political question, with a "political balance to be struck between the purpose for which high excise rates are levied (revenue, dissuasive effects, health grounds, price support, etc.) and the degree to which those rates are so high as to make evasion too attractive." *Id*. § 10.3.3.2.

Member States also exhibit a cultural North/South divide on the issue of smuggling. As a matter of political choice, according to the Report, some of the southern countries, France, Italy and Spain, from time to time place strong emphasis on suppressing smuggling activity, even where they know that this approach might damage their commercial interests. *Id.* § 7.4.2.3. By contrast, in the Netherlands, Belgium and the United Kingdom, customs officials "openly state their interest in placing as few

obstacles in the way of commerce as possible." *Id*. This lack of political priority on the part of the Member States is further reflected in the lack of funding devoted to reforming the transit system. *Id.* § 9.5.2. As the Wilmott Declaration shows, these competing policies between the Member States have produced considerable tension within the EC. (Wilmott Decl. ¶¶ 21, 24.)

The Parliamentary Committee emphasized that this "*willful negligence*" on behalf of the Commission, the Council, and the Member States created the present environment, which leads some Europeans to sell and purchase contraband. *Id.* §§ 9.8.3, 9.8.4. (emphasis added). The EC's attempt to shift the blame from itself to the shoulders of American cigarette manufacturers was rejected by the very Committee that the EC established to investigate smuggling:

> [The public authorities] created and manage a system for the benefit of the economy and society as a whole and thus owe a "duty of care" to the system's users. The argument that the private sector has a role to play cannot therefore be used as an alibi for the abdication of responsibilities on the part of the public authorities.

Id. § 13.4.4.2. The Parliamentary Committee appropriately recognized that "cigarette producers are not law enforcement agencies." *Id*. § 6.5.3.4. The Committee thus concluded that "some of the action to be taken in response to the crisis in transit has to be of an essentially political nature." *Id.* § 16.1.1.1.

After reaching these conclusions, the Committee of Inquiry proposed a host of reforms that would require legislation in the EC or the Member States, administrative action by officials of the EC and Member States, and official cooperation among the Member States. As the Wilmott Declaration reveals, the EC and the Member States

largely failed to implement most of the remedies proposed by the *EC Parliamentary Report*. (Wilmott Decl. ¶ 16). As Mr. Wilmott explains, the fifteen Member States have divergent interests and perspectives, the EC has no power to dictate changes in the Member States' border controls, and there is not even consensus among the Member States on how to reform a transit system that fosters contraband trafficking. (Wilmott Decl. ¶¶ 25-27.)

Reform of the transit system requires political compromise and cooperation among the Member States, the ceding of jealously guarded political powers by some Member States to the EC, its institutions, or other Member States, and the consent of the people in fifteen different nations who have markedly different perspectives and interests respecting these issues. (*See* Wilmott Decl. ¶¶ 19-24.) Instead of addressing these political issues in Europe, the EC, at the urging of American lawyers, asks this Court to embroil itself in these issues – in violation of the EC Treaty, in contravention of the principles of the international and domestic laws under which each of its fifteen Member States operate, and most significant, in disregard of long-standing U.S. law which was reconfirmed by Judge McAvoy and available for the EC's edification six-months before its highly publicized filing.

E. Pending Related Litigation in the Court of First Instance of the European Communities

In the EC court system, the Court of Justice interprets the founding treaties of the EC and ensures that those treaties are enforced. EC Treaty art. 220. The Court of Justice consists of the Court of Justice itself, and a lower court, the Court of First Instance. *Id.* arts. 221, 225. The EC, its institutions, and the Member States are bound by the Court of

Justice's interpretation of Community law. *Id*. arts. 226-239. Because the institution of this lawsuit by the EC is so clearly *ultra vires*, in December 2000, Philip Morris and other defendants filed separate Applications for Annulment in the Court of First Instance of the European Communities.[12] Philip Morris' Application requests the Court of First Instance to annul the EC's action in commencing and pursuing this lawsuit and would essentially require the EC to withdraw the Complaint. Philip Morris requested expedited treatment of this matter. The EC has yet to respond.

The Application for Annulment sets forth in considerable detail, with numerous citations to the binding decisions of th European Court of Justice, the EC's lack of authority to file or pursue this action in an American court; the EC's failure to comply with well-established procedures to obtain the necessary consents from the Member States and other institutions of the EC; and the European legal principles that have been violated by the EC in commencing this action. In addition to demonstrating that only the Member States are authorized to assess and collect customs duties and VAT exclusively in their own national courts and administrative bodies, the Application also documents – as is shown in this memorandum and admitted in the *EC Parliamentary Report* – that the EC has not suffered and cannot suffer any economic harm from the conduct alleged in the Complaint.

[12] Philip Morris continues to request this Court to receive, under seal in order to accommodate the usual practices of the Court of First Instance, its full 43-page Application for Annulment and accompanying exhibits. (*See* Letters from Irvin B. Nathan to the Court dated 12/19/00 (docket #24) and 1/4/01 (docket #57)).

ARGUMENT

I. THIS ACTION IS BARRED BY THE REVENUE RULE

As demonstrated in the simultaneously filed Memorandum of Law in Support of Defendants' Motion to Dismiss Under Rules 12(b)(1) and (b)(7) the Colombian Departments' Complaint for Lack of Subject Matter Jurisdiction and Lack of an Indispensable Party ("Memorandum to Dismiss Colombian Departments' Complaint"), this action is barred by the Revenue Rule.[13] This is a common law rule established in an unbroken line of American cases spanning nearly 200 years holding that U.S. courts lack subject matter jurisdiction to entertain claims by foreign governments seeking to obtain, either directly or indirectly, allegedly lost tax revenues. (*See* Memorandum to Dismiss Colombian Departments' Complaints at Part I). The Revenue Rule bars the claims of the EC and, should any of them join this action, its Member States, to recover allegedly lost taxes and customs duties for the same reason that it bars the virtually identical claims brought by the Departments of Colombia. As the Second Circuit has stated: "It has long been a general rule that one sovereignty may not maintain an action in the courts of another state for the collection of a tax claim." *United States v. First Nat'l City Bank*, 321 F.2d 14, 23-24 (2d Cir. 1963) (citing cases), *rev'd on other grounds*, 379 U.S. 378 (1965).

The U.S. Supreme Court has acknowledged the long standing "principle enunciated in federal and state cases that a court need not give effect to the penal or

[13] For the convenience of the Court, Philip Morris will not repeat those arguments at length here, but instead incorporates herein by reference those relevant portions of the Memorandum to Dismiss the Colombian Departments' Complaint.

revenue laws of foreign countries or sister states." *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 413 (1964). More recently, the Second Circuit has reiterated that federal courts cannot enforce foreign revenue laws because doing so would engulf them in the "forbidden waters" of the Revenue Rule. *See United States v. Trapilo*, 130 F.3d 547, 553 (2d Cir. 1997); *see also United States v. Pierce*, 224 F.3d 158, 163 (2d Cir. 2000) (recognizing the Revenue Rule). Likewise, the First Circuit described the Revenue Rule as "a firmly embedded principle of common law." *United States v. Boots*, 80 F.3d 580, 587 (1st Cir. 1996). And the Ninth Circuit, in rejecting a Canadian claim for its taxes in a U.S. court more than 20 years ago, concluded that:

> The revenue rule has been with us for centuries and as such has become firmly embedded in the law. There were sound reasons which supported its original adoption, and there remain sound reasons supporting its continued validity. When and if the rule is changed, it is a more proper function of the policy-making branches of our government to make such a change.

Her Majesty the Queen v. Gilbertson, 597 F.2d 1161, 1164-66 (9th Cir. 1979).

The definitive American statement on the purpose of the Revenue Rule was provided by the Second Circuit in *Moore v. Mitchell*, 30 F.2d 600 (2d Cir. 1929), *aff'd*, 281 U.S. 18 (1930). In that case, Judge Learned Hand justified the Revenue Rule by explaining that,

> [t]o pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are entrusted to other authorities. It may commit the domestic state to a position which would seriously embarrass its neighbor. Revenue rules fall within the same

> reasoning; they affect a state in matters as vital to its existence as criminal laws.[14]

Id. at 604 (Hand, J., concurring). Given the historical understanding of the need for the rule, American courts have construed *Moore v. Mitchell* as a "case [that] merely reaffirmed and followed a long line of authorities standing for the universally recognized principle that in both federal and state courts, private international law forbids the enforcement by one sovereign of the revenue laws of another." *Bradshaw v. Moyers*, 152 F. Supp. 249, 250 (S.D. Ind. 1957).

Relying upon the universally recognized bar against the direct or indirect enforcement of foreign revenue laws, Judge McAvoy of the Northern District of New York rejected claims, like those the EC asserts here, that were brought by the Government of Canada against R.J. Reynolds alleging that the tobacco manufacturer had somehow violated RICO by fostering the smuggling of cigarettes into Canada. *Attorney General of Canada*, 103 F. Supp. 2d at 141. Prior cases from this Circuit left Judge McAvoy with the inevitable conclusion that the Revenue Rule remains the law of the Second Circuit. *Id.* ("[T]he Court finds the Revenue Rule to be recognized in this Circuit."). Accordingly, Judge McAvoy rejected the strikingly similar claims raised by the Government of Canada, explaining that

> to pursue its claims for damages relating to lost tax revenue, Canada will have to prove, and the Court will have to pass on, the validity of the Canadian revenue laws and their applicability [to Canada's RICO claims] and the Court would be, in essence, enforcing Canadian revenue

[14] *See also, e.g., Bank of Montreal v. Kough*, 612 F.2d 467, 472 n.7 (9th Cir. 1980) (adopting Judge Hand's justification for the Revenue Rule); *Steckler v. Penroad Corp.*, 136 F.2d 197, 202-03 (3d Cir. 1943) (same); *City of Philadelphia v. Cohen*, 184 N.E.2d 167, 169 (N.Y. 1962) (same); *City of Detroit v. Proctor*, 61 A.2d 412, 415 (Del. Super. Ct. 1948) (same); *Bowles v. Barde Steel Co.*, 164 P.2d 692, 713 (Or. 1945) (same); *Lapinski v. Copacino*, 38 A.2d 592, 594-95 (Conn. 1944) (same).

> laws. Enforcing foreign revenue laws is precisely the type of meddling in foreign affairs the Revenue Rule forbids.

Id. at 143 (citations and footnotes omitted).

Judge McAvoy's application of the Revenue Rule, as well as the prior cases from this Circuit, leaves no doubt that the claims asserted by the EC are barred for the same reason that Canada's claims were barred. Nevertheless, the Government of Canada has appealed Judge McAvoy's well-reasoned opinion to the Second Circuit.

Originally, plaintiffs' counsel advised this Court that "nothing the Second Circuit is going to do is going to deprive you of jurisdiction, nor give you any real guidance" in deciding the cases now before the Court. (9/29/00 Tr. at 20 (statement of Mr. Malone).) Now, in marked contrast to those assertions, plaintiffs' counsel, without advising this Court, has filed an *amicus* brief on behalf of the EC in the Second Circuit urging reversal of Judge McAvoy's decision. (Ex. 22.)[15] In rare understatement, plaintiffs' counsel explained in their motion to file an *amicus* brief that "a ruling [by the Second Circuit] on the Revenue Rule could affect the rights and interests" of the EC in its lawsuit. (December 19, 2000 Affidavit of John J. Halloran, Jr., at 4.)

Philip Morris leaves to the Court to consider whether the views expressed in the EC *amicus* brief are those of the EC or those of its American lawyers, who have a vested interest in the EC's suit as well as the Colombian suits. While the EC's *amicus* brief urges that U.S. courts should abrogate the Revenue Rule as bad public policy, every single member of the EC adheres to the Revenue Rule in its own courts. Under the

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[15] Brief of the European Community as *Amicus Curiae* in Support of the Position of the Attorney General of Canada and Reversal of the District Court's Judgment, *Attorney General of Canada v. RJ Reynolds Tobacco Holdings, Inc.*, Docket No. 00-7972 (hereinafter "EC Br.") (Ex. 22).

Revenue Rule, the courts of every Member State would bar claims by the United States and even other Member States seeking to recover lost taxes. *See, e.g.*, *Brokaw v. Seatrain U.K. Ltd.*, [1971] 2 Q.B. 476 (English Court of Appeal 1971) (rejecting claim to enforce tax levy imposed by the United States Internal Revenue Service that had not been reduced to judgment) (Ex. 23); *Aps v. Frandsen*, 1 W.L.R. 2169 (English Court of Appeal 1999) (rejecting attempt to enforce Danish revenue law that had not been reduced to judgment and noting that all Member States' courts would do the same); *see also Brokaw*, [1971] 2 Q.B. 476 (noting in rejecting an indirect revenue claim of the United States that "[i]f the position were reversed, I do not think that the United States courts would enforce our revenue laws. For no country enforces the revenue laws of another").

A. The EC's Member States Recognize that the Revenue Rule Remains Necessary

In its *amicus curiae* brief before the Second Circuit, the EC recites many of the criticisms of the Revenue Rule that have been raised over the past 200 years, but the EC neglects to acknowledge the most important point – that no court in any country at any time has invalidated the Revenue Rule in response.[16] Notably, after having undoubtedly conducted what appears to be an exhaustive investigation of cases addressing the Revenue Rule, the EC is unable to cite a single case decided anywhere in the world in which a court abandoned the Revenue Rule. To the contrary, the most recently published European treatise to address the Revenue Rule concludes that "[t]here is a well-

[16] EC counsel, for example, cites the fact that Justice Story was troubled that the Revenue Rule could be used to assist smugglers, but EC counsel neglects to inform the Second Circuit that – almost 200 years ago – Justice Story concluded in 1818 that it was already too late to depart from the Revenue Rule because it "has been so long established, that it has become almost a formula in our text-books." *The Anne*, 1 F. Cas. 955, 956 (C.C.D. Mass. 1818).

established and almost universal principle that the courts of one country will not enforce the penal and revenue laws of another country." Dicey & Morris, 1 *The Conflict of Laws* 89 (13th ed. 2000) (Ex. 24). The statement by the English House of Lords in *Government of India v. Taylor*, [1955] A.C. 491 (English House of Lords 1955) (Ex. 25), that there is "no case in which a foreign State had recovered taxes by suit in this country nor of any case in any foreign country in which the government of this country had done so" remains as true today as it has been for nearly 200 years. *See also* Hans W. Baade, *The Operation of Foreign Public Law*, 30 Tex. Int'l L. J. 429, 482 (1995) (noting that the Revenue Rule "has never been challenged successfully in an international context").

In their attempt to persuade the Second Circuit to be the first court to depart from the Revenue Rule since its adoption in this country almost two centuries ago, the EC's counsel attacks only the policies that it believes led to the adoption of the Revenue Rule in Britain in the 18th Century. (EC Br. at 5-10.). The EC's counsel suggests to the Second Circuit that the Revenue Rule was initially adopted to further the English smuggling trade and suggests that the retention of the Revenue Rule has been some sort of historical oversight. (*Id.*) The Member States of the EC, however, know better.

While the EC's counsel improperly attacks the motives it assigns to England in adopting the Revenue Rule, the English House of Lords in the late 20th century looked to the explanation for the Revenue Rule offered by Judge Hand in describing the true justifications for its continued reliance upon the Revenue Rule:

> Nor is modern history without examples of revenue laws used for purposes which would not only affront the strongest feelings of neighbouring communities but would run counter to their political aims and vital interests. Such laws have been used for religious and racial

> discriminations, for the furtherance of social policies and ideals dangerous to the security of adjacent countries, and for the direct furtherance of economic warfare . . . . Safety lies only in universal rejection.

Williams and Humbert Ltd. v. W & H Trade Marks (Jersey) Ltd., [1986] A.C. 368 (English House of Lords 1985) (Ex. 26) (quoting *Peter Buchanan Ltd. v. McVey*, [1955] A.C. 516 (Ir. H. Ct. 1951) (Ex. 27)). There is nothing antiquated or outdated in the notion that courts should not enforce foreign revenue laws that undermine the public policy of their own countries or in keeping courts from making foreign policy blunders that would result inevitably from individual courts deciding which country's revenue laws are worthy of enforcement.

B. The EC's Member States Recognize that the Revenue Rule Is Absolute

Remarkably, the EC's counsel brings this action when each of the EC's Member States would invoke the Revenue Rule to deny a similar claim by the United States or even by a fellow Member State. *See Brokaw*, [1971] 2 Q.B. 476 (rejecting effort to indirectly enforce revenue laws of the United States). The Council of the European Union, for example, has found that "it is not at present possible to enforce in one Member State a claim for [tax] recovery substantiated by a document drawn up by the authorities of another Member State." Council Directive 76/308, of 15 March 1976, 1976 O.J. (L 73) 1 (Ex. 28); *see also* Council Directive 79/1071/EEC, of 6 December 1979, Amending Directive 76/308/EEC, 1979 O.J. (L 331) 10 (recognizing that enforcement of revenue laws was not possible absent agreement among Member States) (Ex. 29). Even when the Member States enter into a treaty permitting the enforcement of civil judgments in each of their respective courts, they specifically exempted cases involving "revenue, customs,

or administrative matters." *See* Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. Art. 1., 29 I.L.M. 1413, 1418 (1990).

Limited exceptions from the Revenue Rule exist within the EC solely through international negotiation. European courts have observed that within the Member States of the EC "[t]his rule with regard to revenue laws may in the future be modified by international convention or by the laws of the European Economic Community in order to prevent fraudulent practices which damage all States and benefit no State. But at present the international rule with regard to the non-enforcement of revenue and penal laws is *absolute.*" *Williams and Humbert Ltd.*, [1986] A.C. at 428 (emphasis added).[17] This, of course, is the same position taken by American courts. *See, e.g., Her Majesty the Queen*, 597 F.2d at 1164-66 ("When and if the rule is changed, it is a more proper function of the policy-making branches of our government to make such a change.").

C. The EC's Member States Recognize that the Revenue Rule Is Jurisdictional, Not Discretionary

In addition to asking the Second Circuit to reject the Revenue Rule based on arguments that all other courts have rejected for centuries, the EC's counsel makes the novel claim that the Revenue Rule is discretionary. (EC Br. at 13). The EC's claim that the Revenue Rule is discretionary is remarkable in view of the fact that the EC's counsel cannot identify a single court that has exercised this supposed "discretion." The absence

[17] *See Aps v. Frandsen*, 1 W. L. R. 2169 (relying upon this language from *Williams and Humbert* in recognizing that the Revenue Rule cannot be "circumvented" except by treaty); *Id.* (noting that "we were shown no contrary jurisprudence from any other Member State"); *Lambertini v. Greek Government* (Italian Court of Appeal of Gênes 1932), *reprinted in* 59 Journal du Droit International (1932) ("It is, in effect, a universally accepted principle that the right to collect taxes is one of the *jura regalia* which can only be exercised on behalf of the local sovereign, unless otherwise resolved by international convention.") (Ex. 30).

of such cases is not surprising. The Revenue Rule, by necessity, is absolute. As the leading English treatise explains: "English courts have no jurisdiction to entertain an action: (1) for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign State . . . ." Dicey & Morris, 1 *The Conflict of Laws* 97 (13th ed. 2000). Indeed, that treatise emphasizes that the rule "is framed in terms of lack of jurisdiction." *Id.* at 98; *see also* 8(1) *Halsbury's Laws of England* ¶ 613 at 463 (4th ed. 1996) ("The English court will not enforce a foreign revenue law, either directly or indirectly. An action to collect the taxes of a foreign country will not be entertained in England, irrespective of the identity of the plaintiff or the form in which it is brought.") (Ex. 31).

Transforming the Revenue Rule into a discretionary principle would undermine its very purpose. The success of the Revenue Rule depends on the "universal rejection" of claims to enforce foreign revenue laws. *See Williams and Humbert Ltd.*, [1986] A.C. 368; *Peter Buchanan Ltd.*, [1955] A.C. 516; *Her Majesty the Queen*, 433 F. Supp. at 412 (explaining that "courts should not make this selection process . . . . it is better to entertain no suits at all").

The Revenue Rule prevents a country from having to enforce a foreign revenue law that is against its own public policy, and its categorical rule of exclusion of such cases prevents any country from being offended. Eliminating the Revenue Rule as a categorical bar would invite courts to discriminate between foreign countries in determining which country's laws will be enforced and which will be condemned. Such decisions present inherent and obvious potential to disrupt foreign affairs, and cannot possibly be administered fairly by a multitude of judges on an *ad hoc* basis. Accordingly,

courts are categorically prohibited from enforcing claims seeking lost revenue, and the decision of whether to craft exceptions to the Revenue Rule for favored countries is left to the political branches of government.

D. The Revenue Rule Is Not Limited to the Enforcement of Tax Judgments

Counsel for the EC attempt to create the mistaken impression that the Revenue Rule prohibits only the enforcement of tax judgments and does not apply to unadjudicated foreign tax claims. (EC Br. at 13-17). This argument stands the Revenue Rule on its head. There is no authority to support this proposition, and there are many cases to the contrary. (*See* Memorandum to Dismiss Colombian Departments' Complaint at Part I.A.) Indeed, the EC's *amicus* brief to the Second Circuit contradicts this point by explaining that the early cases establishing the Revenue Rule did not arise in the context of enforcing foreign tax judgments, but instead held that contracts involving the smuggling of goods could not be invalidated because they violated the penal or customs laws of a foreign country. (*See* EC Br. at 5-7.)

The Revenue Rule does not apply merely to tax judgments, but applies to all claims that depend upon a construction of revenue laws. If a foreign tax claim has not been litigated and decided in a foreign country and therefore has not been considered by a court that is expert in the tax at issue, and if the taxpayer has not been accorded all of the process due in that foreign court, then there is all the more reason for an American court to refuse to hear an unlitigated, unassessed, and unadjudicated foreign tax claim.

Application of the Revenue Rule never has depended upon the form of the claim in which the foreign sovereign seeks to collect taxes allegedly due.[18] Recently, for example, the English Court of Appeal applied the Revenue Rule in rejecting a claim – not reduced to a judgment in any country – that would have indirectly enforced the Revenue Rule of a fellow Member State. *Aps*, 1 W.L.R. 2169 ("It is a fundamental principle of English law that our courts will not directly or indirectly enforce the penal, revenue or other public laws of another country."). Member State courts also have used the Revenue Rule to bar claims by the United States for taxes that have not been reduced to judgment. *Brokaw*, [1971] 2 Q.B. 476 (rejecting effort to enforce United States revenue laws through an administrative tax levy).

As a leading treatise explains, the Revenue Rule bars direct claims as well as indirect claims, "where the foreign state (or its nominee) in form seeks a remedy, not based on the foreign rule in question, but which in substance is designed to give it extra-territorial effect . . . ." Dicey & Morris, 1 *The Conflict of Laws* 99 (13th ed. 2000). As the English House of Lords has emphasized: "'In every case the substance of the claim must be scrutinized, and if it then appears that it is really a suit brought for the purpose of collecting the debts of a foreign revenue it must be rejected.'" *Williams and Humbert*

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[18] S*ee Oppenheim's International Law* 489 n.5 (9th ed. 1996) ("The same substantive result – recovery of taxes by or for the foreign state – cannot be achieved indirectly . . . .") (Ex. 32); 8(1) *Halsbury's Laws of England* ¶ 613 at 463 (4th ed. 1996) ("The English court will not enforce a foreign revenue law, either directly or indirectly . . . . irrespective of the identity of the plaintiff or the form in which it is brought."); *see also Williams and Humbert Ltd.*, [1986] A.C. 368 (English House of Lords 1986) (quoting *Peter Buchanan Ltd.*, [1955] A.C. 516 at 527) (holding that the Revenue Rule applies "'where it appears that the enforcement of the right claimed would indirectly involve the execution of the revenue law of another State, and serve a revenue demand.'"); *Government of India v. Taylor*, [1955] A.C. 491 (English House of Lords 1955) ("[I]n no circumstances will the courts directly or indirectly enforce the revenue laws of another country."); *Days Inns of America Franchising Inc. v. Khimani*, [1992] 11 C.P.C. (3d) 74 (Ontario Court of Justice 1992) (similar) (Ex. 33).

Ltd., [1986] A.C. 368 (English House of Lords 1986) (quoting *Peter Buchanan Ltd,* [1955] A.C. 516 (Ir. H. Ct. 1950) (Moore, J.)). Moreover, European courts have emphasized "the importance of guarding against any attempt to evade the rule or to whittle away the scope of its application." *Peter Buchanan Ltd,* [1955] A.C. 516 (Ir. H. Ct. 1950) (Moore, J.).

* * *

Given that the Revenue Rule originated within the EC's Member States, and that each of the Member States continues to enforce it in absolute terms, it is the height of hypocrisy for the EC's counsel to make representations to United States courts urging them to disregard the Revenue Rule in our country. The obvious lesson from more than 200 years of cases applying the Revenue Rule in the United States as well as throughout Europe is that claims like those raised by the EC have been rejected categorically without exception. The same result is required here. The Member States of the EC surely recognize that the only way claims for foreign taxes could be permitted in American courts would be to negotiate a treaty with the United States that would confer some reciprocal benefit for the United States to bring such claims in their courts. No United States court should undermine the political decision of the Executive Branch not to confer such a benefit upon the EC or its Member States. Nor should a United States court otherwise undermine the Executive Branch's ability to negotiate a modification of the Revenue Rule on terms favorable to the United States. Accordingly, under the Revenue Rule, the Complaint should be dismissed in its entirety.

II. THE EC LACKS STANDING TO BRING THIS ACTION ON ITS OWN BEHALF

This action also should be dismissed because the EC does not meet constitutional standing requirements. This Court lacks subject matter jurisdiction because the EC has not met the threshold standing requirement that the allegations of the Complaint show that plaintiff has suffered "injury in fact." *Friends of the Earth v. Laidlaw Envtl. Servs., Inc.*, 528 U.S. 167, 180 (2000).

As the U.S. Supreme Court stated in *Friends of the Earth*: "[T]o satisfy Article III's standing requirements, a plaintiff must show (1) it has suffered an 'injury in fact' that is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical . . . ." *Id.* Moreover, the Supreme Court has made it clear that it will "presume that federal courts lack jurisdiction unless the contrary appears affirmatively from the record," *Renne v. Geary*, 501 U.S. 312, 316 (1991) (internal citations omitted), and that "[i]t is the responsibility of the complainant clearly to allege facts demonstrating that he is a proper party to invoke judicial resolution of the dispute and the exercise of the court's remedial powers." *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534, 546 n.8 (1986) (citation omitted).

As described below, the EC suffered no injury from any alleged failure of importers or smugglers to pay applicable VAT or customs duties to the Member States because the Member States must compensate the EC for any budgetary shortfall. Indeed, in each of the potential damage years – the four years prior to the filing of the lawsuit on November 3, 2000 – the EC had revenues that exceeded its budgeted expenditures. The EC had no shortfall in its budgets and therefore suffered no injury in fact. The EC's own Parliamentary Committee Report contains a fatal admission:

> In the system of Community finance, any shortfall in such revenue (along with agricultural levies) is in practice compensated by higher payments from the Member States under the so-called "fourth resource," calculated on the basis of national GNP. The cost of transit fraud to the Community is therefore ultimately borne by the Member States . . . .

EC Parliamentary Report § 4.2.1.2. As explained below, the EC has no claim of injury that would provide this Court with subject matter jurisdiction.

A. The EC Finance and Import Tax System is Designed to Guarantee that the EC Receives All of its Budgeted Revenue

The description of the EC budget system makes clear that any uncollected import duties or VAT cannot cause a shortfall in budgeted revenue and therefore cannot cause any injury to the EC. Every year, the EC sets a budget that estimates and authorizes expenses for its financial year. EC Treaty art. 268; *see also* John P. Flaherty & Maureen E. Lally-Green, *The European Union: Where Is It Now*, 34 Duq. L. Rev. 923, 974 (1996); Christopher Bovis, *Legal Aspects of the European Union's Public Finances: The Budget and the Communities' Own Resources System*, 28 Int'l Law. 743, 747 (1994). The European Commission (which is the administrative arm of the EC) prepares the preliminary draft budget, and is solely responsible for implementing the budget. EC Treaty arts. 272-74. From its inception in 1957 through 1970, the EC's budget was financed exclusively by voluntary contributions from Member States. *See* Special Report of Council of Auditors No. 6/98, 1998 O.J. (C 241) 58, 60 ¶ 2.3. This system produced inordinate dependence on the Member States and was modified in 1970 by the introduction of the system known as "own resources." *Id*. ¶ 2.4.

The introduction of "own resources" identified certain sources of revenue that the Member States were required to collect and that served as the basis for determining the

contribution of each Member State to the EC's budget. From their introduction in 1971 until 1988, three "own resources" revenue sources were designated in connection with the EC's budget: (1) agricultural duties; (2) duties from the Common Customs Tariff; and (3) a portion of the VAT collected by the Member States.[19] Own Resources Decision, Art. 2, 1994 O.J. (L 293) 10.

Although designed in part to remedy the problems with the prior funding system (which left EC budgetary funding subject to the will of the Member States), the "own resources" system had problems of its own in that there was no assurance that funds designated for the EC's budget would ever be collected by the Member States. Specifically, before the EC's right to funds vests as "own resources," the Member States had actually to collect the funds from taxpayers in accordance with complex procedures. *See* Own Resources Regulation, art. 2, 6(3) 2000 O.J. (L 130) 2 (describing procedures Member States must follow for "own resources" based on import duties and VAT to vest with the EC). Failure by Member States to collect duties or VAT that served as the basis for "own resources" left the EC's budget vulnerable to shortfalls.

In 1988, however, the EC introduced a fourth "own resource" designed as a "buffer" to ensure that the EC's budget is never adversely affected by the failure of the Member States to collect VAT, duties, or other revenue designated as "own resources." Own Resources Report § 1.1, at 4. The existence and actual use of that "fourth own

[19] In addition to these resources, the EC budget receives revenue from other sources, which are not considered "own resources." These revenues include fines, interest on late payments, income from borrowing and lending operations and other miscellaneous revenues. Own Resources Report § 1.1, at 4.

resource" – which ensures that the EC can never suffer any losses as the result of smuggling or for any other reason – is fatal to the EC's right to bring this action.

The "fourth own resource" is an amount calculated as a percentage of the GNP of each individual Member State. Own Resources Decision, art. 2(1)(d), 1994 O.J. (L 293) 9; Own Resources Regulation, art. 13, 2000 O.J. (L 130) 7. Under EC law, the percentage of GNP own resources is calculated in "such a manner that it fully covers that part of the budget not financed from" the other three own resources. Own Resources Regulation, art. 5, 2000 O.J. (L 130) 3. As explained by the Commission itself, "[a]ny loss in the collection of [the other own resources] in a Member State must be made up by a corresponding increase in the GNP resource." Own Resources Report §1.2.2, at 9.[20] "[I]n consequence, the necessary resources are *guaranteed*." Special Report of Court of Auditors No. 6/98, 1998 O.J. (C 241) 61 ¶ 3.2 (emphasis added).

The GNP "own resource" serves as a "buffer" or "plug" bringing revenue into equalization with expenditure.[21] It is calculated by "the application of a rate – to be determined under the budgetary procedure in light of the total of all other revenue [levies, duties, and VAT] – to the sum of all Member States' GNP."[22] *Id*. Thus, this "GNP

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[20] *See also* Court of Auditor's GNP Data Report, 2000 O.J. (C 336) 4 ¶ 7 ("the GNP resource . . . forms part of the budget funding and is used to make up the difference between planned expenditure and the other resources available (customs duties, agricultural duties and the VAT resource).")

[21] *See* Council Decision 88/376/EEC, art. 2(1)(d), Euratom, of June 24, 1988, on the System of the Communities' Own Resources, 1998 O.J. (L 185) 3 (Ex. 34).

[22] This procedure recently has been confirmed. *See* Own Resources Regulation, art. 5, 2000 O.J. (L 130) 3 ("The rate referred to in Article 2(1)(d) of Decision 94/728/EC, Euratom which shall be set within the budgetary procedure, shall be calculated as a percentage of the sum of the forecast of the gross national product, (hereinafter referred to as 'GNP') of the Member States in *such a manner that it fully covers that part of the budget not financed* from customs duties, agricultural levies, levies, and other charges connected with the common organisation of the market in the sugar sector, VAT resources, financial contributions to supplementary research and technological development programmes, other revenue and, where appropriate, GNP financial contributions.") (emphasis added).

resource" ensures that there can never be a shortfall in the EC's budget and that the EC therefore is unaffected by any failure of the Member States to collect VAT and duties on imported products, whether imported lawfully or not.

B. Because the "Fourth Resource" Prevents Any Losses to the EC from the Failure of the Member States to Collect VAT and Duties, the EC Could Not Have Suffered Any Injury in fact as a Result of Alleged Smuggling

The smuggling alleged in the Complaint could not cause the EC any injury because the EC's financing system prevents the EC from being injured by any shortfalls in revenue collection by the Member States. The "fourth resource," both in theory and in practice, requires the Member States to fund fully the EC's budget whether or not the Member States collect all of the tax revenues that are owed. In the last four years, there have been no budgetary shortfalls as a result of smuggling. As noted, the EC actually ran budget surpluses in each of these years.

Neither customs duties nor VAT are paid directly to the EC by importers, but are instead paid to the Member States. EC law charges the Member States with the obligation to satisfy the "own resources" debt to the EC. Own Resources Decision, art. 8(1), 1994 O.J. (L 293) 12; Own Resources Regulation, art. 17(1), 2000 O.J. (L 130) 8. In the event that smuggling occurs and would otherwise cause a shortfall in anticipated collections of VAT or customs duties, the Member States cannot avoid their obligation to the EC. Rather, the EC increases the Member States' contribution under the fourth "own resource" to ensure that the EC's budget balances. Own Resources Report § 1.2.2, at 9; *see also* Court of Auditor's GNP Data Report, 2000 O.J. (C 336) 4, at ¶ 7; Special Report of the Court of Auditors No. 6/98, 1998 O.J. (C 241) 61, at ¶ 3.2. The fact that shortfalls

in revenue collection by the Member States are not passed on to the EC demonstrates that the EC could never be injured by the conduct alleged in the Complaint. As noted, the EC explicitly has admitted as much. The Parliamentary Committee established by the European Parliament to advise the EC on smuggling matters, specifically found that the fourth "own resource" prevents the EC from suffering any budget shortfalls that may otherwise result from smuggling. *EC Parliamentary Report* § 4.2.1.2.

The EC's actual overall revenue stream from Member States cannot be – and, indeed, has not been – lower than the budgeted amount. In the event that revenues collected from customs duties and VAT exceed budgetary projections, those surpluses are used to reduce the Member States GNP resource contributions in the following years. "[F]or example, the budget surplus of 1989 reduced GNP financing in 1990 to a minimum." Own Resources Report §1.1 at 4. From 1996 to 1999, despite the "billions" of dollars allegedly lost as a result of smuggling, the EC has enjoyed a net budget surplus (*i.e.*, revenues minus expenditures) in each of those years: approximately 3 billion Euro in 1999; nearly 3 billion Euro in 1998; 962 million Euro in 1997; and 4.4 billion Euro in 1996.[23]

In short, any alleged illegal smuggling activity and alleged nonpayment of duties and VAT assessed by Member States could not and has not deprived the EC of any revenue. Accordingly, the EC has no claim for any actual harm, much less legally

[23] *See* 1999 Revenue and Expenditure Account and Balance Sheet, 2000 O.J. (C 343) 8; 1998 Revenue and Expenditure Account and Balance Sheet, 1999 O.J. (C 350) 13; 1997 Revenue and Expenditure Account and Balance Sheet, 1998 O.J. (C 350) 13; 1996 Revenue and Expenditure Account and Balance Sheet, 1997 O.J. (C 349) 12.

cognizable harm. As it has not been injured in fact, the EC has no standing to bring this suit, and the Complaint should be dismissed.

III. LACKING ANY INJURY OF ITS OWN, THE EC HAS NO STANDING TO FILE SUIT ON BEHALF OF THE MEMBER STATES

Not only does the EC lack standing to bring this lawsuit on its own behalf, but, under the treaties establishing the powers of the EC, the EC also has no authority to bring this lawsuit on behalf of the Member States in the United States. The provisions of the EC Treaty misleadingly cited in the Complaint do not provide authority for the EC to file lawsuits outside of its own courts and the courts of its Member States.

Lacking standing and authority to sue for itself, the EC claims that it is bringing this case not only "on its own behalf" but also "on behalf of the Members States it has power to represent." (Compl. p. 1.) This claim too must fail. Because the EC has suffered no injury of its own, the EC does not have standing to sue on behalf of any Member State. Where, as here, the Member States can bring their own claims in their own courts, the EC cannot litigate as a volunteer on their behalf.

"The Art. III judicial power exists only to redress or otherwise to protect against injury to the complaining party." *Warth v. Seldin*, 422 U.S. 490, 499 (1975). Whatever interest the EC has in seeing that its Member States receive all of the taxes that are owed is not sufficient to give the EC standing to sue when the EC itself has not been injured. *See, e.g., Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 120 S. Ct. 1858, 1862 (2000) ("An interest unrelated to injury in fact is insufficient to give a plaintiff standing."). As the Supreme Court recently explained in rejecting a plaintiff's claims that a defendant owed the United States a civil penalty for violating U.S. law:

> By the mere bringing of his suit, every plaintiff demonstrates his belief that a favorable judgment will make him happier. But although a suitor may derive great comfort and joy from the fact that the United States Treasury is not cheated, that a wrongdoer gets his just deserts, or that the Nation's laws are faithfully enforced, that psychic satisfaction is not an acceptable Article III remedy because it does not redress a cognizable Article III injury.

Steel Co. v. Citizens for A Better Env't., 523 U.S. 83, 107 (1998).

Likewise, the EC's desire to punish entities that allegedly facilitated smuggling is insufficient to confer standing upon the EC in an American court. As recognized repeatedly in the Second Circuit, when a sovereign state brings a RICO claim on behalf of the interests of its constituents or third parties, the sovereign has standing only if it has suffered injuries separate from those of the absent constituents it purports to represent. *See New York v. Seneci*, 817 F.2d 1015, 1017-18 (2d Cir. 1987) ("Here, in contrast, a monetary award is sought solely for injury to the business or property of the state's citizens [and not the state]. The issue before us, therefore, is whether the state has standing to sue in a representative capacity to recover those damages. We hold that it does not."); *Dillon v. Combs*, 895 F.2d 1175, 1177 (7th Cir. 1990) ("Indiana does not contend, however, that it is a victim of fraud, and RICO does not authorize a state to obtain relief on account of a fraud practiced against its residents."); *see also Town of West Hartford v. Operation Rescue*, 915 F.2d 92, 102 (2d Cir. 1990). These courts hold that when a State seeks to sue on behalf of its constituents, it "must seek to redress an injury to an interest that is separate from the interests of particular individuals. The state cannot merely litigate as a volunteer the personal claims of its competent citizens." *Seneci*, 817 F.2d at 1017; *Town of West Hartford*, 915 F.2d at 102 (quoting same).

Here, the EC, like the states in those cases, has suffered no injuries of its own, and therefore "cannot merely litigate as a volunteer the personal claims of its competent [constituents]," particularly where the Member States have the ability to bring their own claims in their own courts. *Seneci*, 817 F.2d at 1017; *Town of West Hartford*, 915 F.2d at 102.

IV. THE MEMBER STATES ARE INDISPENSABLE PARTIES BECAUSE THEIR ABSENCE EXPOSES DEFENDANTS TO MULTIPLE SUITS FOR THE SAME ALLEGED INJURIES

All of the Member States are indispensable parties under Federal Rule of Civil Procedure 19(a)(2)(ii) because failure to include each of the Member States as parties subjects Philip Morris to the substantial risk of incurring multiple obligations. EC law clearly holds that the Member States have the exclusive authority to pursue claims for unpaid VAT and customs duties in their own countries. *See* Own Resources Decision, art. 8(1), 1994 O.J. (L 293) 12; Own Resources Regulation, arts. 2, 3, 4, 6, 7, 8, 9 & 10, 2000 O.J. (L 130) 2-7. Philip Morris thus could face multiple judgments and inconsistent injunctive relief based on the same facts, allegations and claims already asserted in the present action. To overcome the Rule 19(a) problem, the Court would have to determine, as a matter of EC law, but contrary to prior decisions by the European Court of Justice, that the EC has the exclusive authority to enforce and collect "own resources."[24]

[24] The issue of the EC's authority to bring this suit, in its on right or own behalf of the Member States, is presently pending before the European Court of First Instance. Given the numerous legal grounds that require dismissal of this suit, Philip Morris respectfully submits that the Court does not need to reach the question of the EC's authority to file suit. Moreover, an opinion by the Court of First Instance would clarify this issue and be binding on both the EC as well as the non-party Member States. However, if the question is left open by the Court of First Instance or if, for any reason, this Court wishes to consider the question, then Philip Morris respectfully requests the right to file a supplemental brief at the appropriate time on the question of the EC's authority under European law to initiate this action.

EC law is clear that the Member States have the sole authority to bring claims for unpaid VAT and customs duties. *See* Own Resources Decision, art. 8(1), 1994 O.J. (L 293) 12; Own Resources Regulation, arts. 2, 3, 4, 6, 7, 9 & 10, 2000 O.J. (L 130) 2-7. The European Court of Justice, for example, has held that "disputes relating to the recovery of sums levied [by Member States] on behalf of the Community therefore come within the jurisdiction of national courts [of the Member States] and *must* be settled by *those courts* in application of *their national law . . . .*" Case 130/79, *Express Dairy Foods Ltd. v. Intervention Bd. for Ag. Produce*, 1980 E.C.R. 1888, ¶ 11 (emphasis added) (Ex. 35).

The European Court of Justice has been just as emphatic in holding that the Member States alone have the authority to pursue claims based on smuggling. *See Pretore di Cento*, 1977 E.C.R. at ¶¶ 3, 6. In *Pretore*, the Court of Justice examined whether "Community institutions are empowered to take proceedings for the recovery of the duties" lost by smuggling and ruled that

> it continues to be the task of the Member States to undertake prosecutions and proceedings for the purpose of the recovery of own resources [*e.g.* duties] and to continue to take steps to that end in respect of persons liable for payment. It follows that in the present state of Community law *only the Member States and their authorities* are empowered to take proceedings before national courts for the purpose of *claiming payment of Community revenue constituting own resources*.

Id. at ¶¶ 3, 6 (emphasis added). Under the principle of "subsidiarity" embodied in the EC Treaty, the EC cannot act where, as here, the area is within the exclusive competence of the Member States. *See* EC Treaty arts. 5 & 7. Indeed, to grant the EC authority to pursue claims for unpaid VAT or duties would require modifications to the EC Treaty

which in turn would require the unanimous consent of the Member States. *See The European Community-International Personality Pre- and Post-1992*, 84 Am. Soc'y Int'l L. Proc. 213, 215 (1991) (Remarks of Prof. Torsten Stein) ("[T]he ultimate responsibility for law enforcement lies with the member states. If we wanted to change this, and if we wanted to confer more powers to the EC and give up competences from the member states and shift them to the Communities, we would need another treaty."). Consequently, the EC cannot unilaterally transfer the sovereign rights of the Member States to itself.

Despite this well-settled law, the EC claims authority to initiate litigation on behalf of the Member States under Article 280(1) of the EC Treaty. But that Article addresses only the EC's authority to pass legislation to counter fraud. As explained above, the exclusive authority to bring enforcement actions for fraud lies with the Member States. Paragraph 6 of the Complaint paraphrases Article 280(1), but omits the language underlined below:

> [T]he Community and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Community through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States.

EC Treaty art. 280 (underlining added). By omitting this underlined language, the EC neglects to inform the Court that its right to take any action to counter fraud must be "in accordance with this Article." Paragraph 6 is misleading because actions "in accordance with this Article" are limited to legislation, and, in any event, the EC did not follow the procedural requirements of Article 280. *See* EC Treaty arts. 280(4), 251.

Federal Rule of Civil Procedure 19 mandates the dismissal of a lawsuit where parties that are both "necessary" and "indispensable" are not named in the action. Fed. R. Civ. P. 19(a)-(b). A non-party is "necessary" if the absence of that non-party from the case subjects a defendant to "a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reasons of the claimed interest." Fed. R. Civ. P. 19(a). When the necessary parties are sovereign, they are deemed "indispensable" as a matter of law because sovereign immunity precludes their joinder. *See Fluent v. Salamanca Indian Lease Auth.*, 928 F.2d 542, 548 (2d Cir. 1991); *see also Sty-Lite Co. v. Eminent Sportswear, Inc.*, 115 F. Supp. 2d 394, 400 (S.D.N.Y. 2000).

Even though the EC purports to be acting on their behalf, absent a binding decision by the Court of First Instance, the Member States could still seek to bring the identical claims separately in their own names in foreign courts. This would subject the defendants to the risk of multiple litigation and therefore mandates dismissal under Rule 19. *See Avon Cosmetics (FEBO) Ltd. v. New Hampton, Inc.*, No. 90 Civ. 7208 (RLC), 1991 WL 90808, *4 (S.D.N.Y. May 22, 1991) (providing that "the facts and circumstances of this case are such that a judgment rendered in Avon's absence exposes [defendant] to a substantial risk of double liability, or at the very least, a substantial risk of double litigation over the same subject matter. Due to basic principles of res judicata and collateral estoppel the court cannot shape the relief to reduce or eliminate this risk without Avon as a party to this action."). That this is a real risk is evidenced by recent press reports that a few Member States are contemplating bringing their own claims against these same defendants based on the same allegations in this Complaint. (*See* Exs. 6 & 7).

For the same reasons, Rule 17(a) requires dismissal. Federal Rule of Civil Procedure 17(a) requires that "[e]very action shall be prosecuted in the name of the real party in interest." As the Second Circuit has emphasized, courts must strictly apply the real party in interest rule to prevent the risk that "a defendant might be exposed to multiple suits based on the same claim." *Rodriguez v. Compass Shipping Co., Ltd.*, 617 F.2d 955, 958 (2d Cir. 1980). If the EC is permitted to litigate the claims asserted in the Complaint here in this Court, a judgment in favor of defendants would be a hollow one, as each of the fifteen Member States could argue that it is not barred by *res judicata* and could seek to litigate the same claims against defendants in each of their national courts. Rule 17(a) was designed to prevent this very predicament.[25]

V. THIS ACTION RAISES POLITICAL QUESTIONS UNDER U.S. AND EC LAW THAT ARE NOT JUSTICIABLE

The effort to resolve the claims raised by the EC's Complaint would force this Court to delve into and decide political questions that are not easily susceptible to judicial review and that are within the exclusive authority of the political branches. *First*, to allow the EC's suit to proceed, the Court would need to decide the threshold question of whether it is the EC or the Member States that have the sovereign authority to bring these claims. Resolving that issue would require this Court to determine the extent to which the Member States have transferred their sovereignty to the EC. Federal courts of the United States are not empowered to draw such distinctions between the respective powers

[25] As noted, the recent campaign by the EC to encourage individual Member States to join this action suggests that the EC realizes that it is the wrong party, or at least, inadequate and that the Member States are the indispensable, real parties in interest. However, even if the EC is successful in getting a few States to join, that will not solve the Rule 19 problem. Without all fifteen Member States, this action lacks indispensable parties, as well as real parties in interest. Accordingly, the action must be dismissed.

of foreign sovereigns. Those determinations are constitutionally committed to the Executive Branch and, as discussed below, any suit that would force a U.S. court to decide such questions must be dismissed.

Second, if this Court were to wade into the merits of the EC's causes of actions under RICO or U.S. common law, the Court would be forced to address numerous political questions that have been the subject of great debate in Europe and that could have significant repercussions on United States foreign policy. In particular, the causes and remedies for smuggling in the EC have been the focus of extensive political dialogue in Europe, including the Parliamentary Committee. After extensive proceedings, the Parliamentary Committee concluded that the EC and its Member States bear primary responsibility for failure to adopt policies and procedures that would reduce smuggling in Europe. *EC Parliamentary Report* § 9.8. Examining the policies and actions of the EC and each of its fifteen Member States in assessing the Complaint's allegations against defendants with respect to smuggling into the EC would enmesh this Court in contentious foreign political questions of the sort that have routinely led U.S. courts to dismiss such cases for lack of jurisdiction.

A. The Complaint Raises Political Questions as to Whether the EC Has Authority to Act as the Plaintiff in this Case

In pursuing this suit purportedly on its own behalf and on behalf of its Member States, the EC presents this Court with the sensitive political question of whether the Member States transferred their sovereign right to enforce their own laws to the EC and, in particular, whether the EC is authorized to represent the Member States before non-Member State tribunals on tax-related matters. The difficult question of whether the EC

or its Member States speaks on a particular issue has caused a great deal of confusion in international relations.

"The law of the Community's external relations has significant constitutional implications that have to do with the Community's institutional system and the division of powers between the Community and its Member States." Jacques H. J. Bourgeois, *External Relations Powers of the European Community*, 22 Fordham Int'l L.J. S149, S169 (1999). Obviously, "the broader the scope of EC powers, the narrower the scope for Member States to act on their own in this field." *Id.* at S156. In view of this fact, Charles Ludolph, then-Director of the U.S. Department of Commerce's Office of European Community, warned: "For the United States to unilaterally recognize the European Community in any way beyond what the member states individually assert would be a breach in international relations with the existing member states." *The European Community-International Personality Pre- and Post-1992*, 84 Am. Soc'y Int'l L. Proc. 213, 222-23 (1992).

The U.S. Executive Branch has recognized the EC and each of its fifteen Member States, but the Executive Branch has not delineated which (if any) of these entities would have the sovereignty to assert the types of claims raised by this Complaint. The United States and other countries ordinarily require the EC and the Member States specifically to set out their respective spheres of authority on particular issues, precisely because it is inherently difficult for other countries to distinguish between the authority of the EC and the Member States:

> [T]he Community and Member States are reluctant to clarify their respective obligations, more often than not because their internal allocation of powers is currently

> under consideration and may change in the future. In order to solve this conundrum and avoid further complications, third parties have tended recently to insist on a statement demarcating the respective fields of competence of the Community and its members, before they allow the Community to participate in international treaties. Thus, such a subordination statement was required as a condition for Community participation, e.g., in the Law of the Sea Convention, the Vienna Convention for the Protection of the Ozone Layer, the Convention on Biological Diversity, and the Framework Convention on Climate Change.

Maria Gavouneli, *International Law Aspects of the European Union*, 8 Tul. J. Int'l & Comp. L. 147, 162 (2000).[26]

It often has been observed that, through the EC, "[t]he member states thus present to third parties a Janus face of both concerted and individual action." *Id.* at 147. Then-Director Ludolph explained that, "from the standpoint of how the United States perceives its ability to enter into some relationship [with the EC], it is extremely limited by this mixed competency issue [between the EC and its various Member States]." *The European Community, supra*, 84 Am. Soc'y Int'l L. Proc. at 227 (Remarks of Dir. Ludolph). By way of example, Ludolph noted that in negotiations concerning airframe manufacturer Airbus Industrie, "[o]ne year France, Germany, Britain and sometimes Spain assert their independent right to deal on the issue of Airbus, and the next year for various political and bureaucratic reasons the member states recede, and use the Commission." *Id*. Ludolph concluded that he would not be sure whether any agreement

[26] *See The European Community-International Personality Pre- and Post-1992*, 84 Am. Soc'y Int'l L. Proc. 213, 216-17 (1992) (Remarks of Prof. Torstein Stein) ("If you remember the Law of the Sea Convention negotiations, the question was not so much should the EC join, but rather how were third states to know who was responsible for what area. In the end the answer was that both the EC and the individual member states could join the Law of the Sea Convention per a mixed agreement. The EC had to expressly state the distribution of competences beforehand, which the Commission did not like very much.").

that was reached with the EC would be with the right party or whether such an agreement would be "enforceable anywhere." *Id.*

The fact that the Executive Branch of the United States and political leaders of other countries have such difficulty demarcating the divided responsibilities between the EC and the Member States reinforces the danger of allowing questions of sovereignty to be resolved by courts. The inherently political nature of such issues requires that they be decided by the Executive Branch, rather than by individual courts acting on an *ad hoc* basis.

This Court, therefore, lacks jurisdiction to resolve the political question of which sovereign – the EC or the individual Member States – has the authority to assert the tax claims in this lawsuit. For this reason, the Complaint must be dismissed as not justiciable. As the Fifth Circuit has explained, "the question of sovereignty is committed to the executive branch by the Constitution, and decision on the issue is impossible in the absence of the executive policy decision." *Occidental of Umm al Qaywayn, Inc. v. A Certain Cargo of Petroleum Laden Aboard the Tanker Dauntless Colocotronis*, 577 F.2d 1196, 1204 (5th Cir. 1978). That court emphasized that "[t]he issue of sovereignty is political not only for its impact on the executive branch, but also because judicial or manageable standards are lacking for its determination." *Id.*

The *Occidental* case addressed a political question very much like the political question posed by the EC's Complaint. In *Occidental*, private parties litigated the ownership of oil extracted from the Persian Gulf. One party claimed to have the mineral rights to the oil under a grant from Britain (as the legal protectorate for one of its territories) and the other claimed the identical right under a conflicting grant from Iran.

While the United States recognized both Britain and Iran, it was unclear whether this disputed border area fell within the sovereignty of Britain or Iran. The Fifth Circuit determined that it could not resolve this question of sovereignty in the absence of guidance from the Executive Branch and dismissed the case as not justiciable. *Id.*

As in *Occidental*, dismissal is required here because the Executive Branch has not provided this Court with any meaningful guidance as to whether the types of claims asserted here are within the sovereign authority of either the EC or the individual Member States. As explained in other sections of this memorandum, it seems clear that the Member States have not conferred authority on the EC to enforce Member State tax laws, and, in particular, to seek unpaid taxes before non-Member State courts. These sensitive political questions are best left to resolution by the EC's Court of First Instance and by the Executive Branch of the U.S. Government. As in the *Occidental* case, American courts have no authority to resolve the questions of sovereignty raised by the EC's Complaint and, therefore, the Complaint should be dismissed.

B. Efforts to Resolve the Merits of the EC Complaint Would Enmesh this Court and the United States in Sensitive Political Controversies in Europe

Alleging that the defendants are the proximate cause of smuggling in Europe, the EC attempts to seek indemnification from American and foreign tobacco companies for tax losses suffered by the Member States that the Parliamentary Committee found were caused by the political failures of the EC and the Member States to establish policies and procedures that would reduce smuggling by Europeans in Europe. The EC itself, however, has acknowledged that the EC and its Member States – rather than American cigarette manufacturers – are in large part to blame for the problems of smuggling in

Europe. As noted above, the EC Parliamentary Committee concluded that "[t]he lack of foresight by the Commission in the introduction of the single market, which has been guided by principles of market liberalization and the abolition of controls rather than those of safeguarding revenue and maintaining the Community's own resources, has led to a crisis within the transit procedure." *EC Parliamentary Report* § 3.1.2.1. The failing transit system, in turn, has fostered an environment conducive to smuggling. As described below, the *EC Parliamentary Report* found that the problem results from a combination of several institutional factors, not one of which falls under the control of cigarette manufacturers.

To the extent that the United States seeks to involve itself in this European dispute, the Executive Branch alone should determine the position of the United States and the scope of this country's involvement. United States courts should not and do not inject the United States into these political controversies; they dismiss those suits as raising political questions. *See, e.g.*, *Occidental*, 577 F.2d at 1204 (political question involving foreign affairs compelled dismissal of complaint); *Burger-Fisher v. Degussa AG*, 65 F. Supp. 2d 248, 282-85 (D.N.J. 1999) (same); *Linder v. Calero Portocarrero*, 747 F. Supp. 1452, 1468 (S.D. Fla. 1990), *aff'd in part, rev'd in part*, 963 F.2d 332 (11th Cir. 1992) ("While we recognize that Plaintiffs' claims represent only an action against the groups and individuals named as defendants, rather than a direct challenge to the conduct of foreign affairs by the political branches, we are required to examine 'the

possible consequences of judicial action' as they broadly affect foreign affairs.") (citing cases in which litigation between private individuals raise political questions).[27]

1. The Deficient Transit System of the EC and its Member States Encourages Smuggling

The EC's "obsolete, error-ridden, fraud-prone and unpoliceable" transit system allows smuggling to flourish in Europe. *EC Parliamentary Report* § 9.1.1.2. Utilizing a cumbersome process involving the manual exchange of paper documents among different countries, this "archaic paper-based procedure" is extremely vulnerable to fraud. *Id*. §

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[27] For example, numerous American states have sued the United States for its failure to preclude illegal entry by aliens at their borders. Each of those cases has been dismissed. *See, e.g., Texas v. United States*, 106 F.3d 661 (5th Cir. 1997); *California v. United States*, 104 F.3d 1086 (9th Cir. 1997); *Padavan v. United States*, 82 F.3d 23 (2d Cir. 1996); *New Jersey v. United States*, 91 F.3d 463 (3rd Cir. 1996). In explaining why the political questions concerning border control issues necessitated dismissal, the Third Circuit explained:

> Decisions about how best to enforce the nation's immigration laws in order to minimize the number of illegal aliens crossing our borders patently involve policy judgments about resource allocation and enforcement methods. Such issues fall squarely within a substantive area clearly committed by the Constitution to the political branches; they are by their nature peculiarly appropriate to resolution by the political branches of government both because there are 'no judicially discoverable and manageable standards for resolving' them and because independent resolution of such issues by a court would express lack of the respect due a coordinate branch of government.

New Jersey, 91 F.3d at 470. Likewise, in the *Chiles v. United* States, 874 F. Supp. 1334 (S.D. Fla. 1994), the court explained that:

> [I]n order to grant the restitution requested by Plaintiffs, the court would be forced to review the United States entire enforcement of federal immigration laws including the enforcement methods used and their effectiveness, determine the reasonableness of budget allocations, determine whether more resources are available and, if so, determine how those additional resources should be allocated. The court is unable to identify satisfactory criteria for making these determinations. This is clearly beyond the Judiciary's authority, and should be left to the Legislative and Executive branches of government.

Id. at 1344.

3.4.1. The EC Parliamentary Committee examining the problems of smuggling concluded that numerous weaknesses in the transit system encourage fraud:

- **Out-dated methods of tracking goods**. In the EC's transit system goods can disappear *en route* to their official destination "in the confident expectation that by the time the deadlines for arrival at destination, return of [transit documents], initiation of inquiry procedure and replies to the inquires have passed, the fraudster will have had adequate time to make his profit and disappear." *Id*. § 3.3.6.2.

- **The lack of border controls.** The lack of border controls allows goods to just "disappear" anywhere in the EC. "A vehicle traveling, for example, between a point of departure in Denmark to a destination in Portugal would probably travel through Denmark, Germany, the Netherlands, Belgium, France and Spain before reaching Portugal. None of these countries would normally be aware of the presence of the vehicle on their territory." *Id.* § 3.3.4.3.

- **Official neglect**. Customs officials seldom physically check goods. This failure allows smugglers to misdeclare the goods on the transit documentation. *Id*. § 3.3.6.4.

- **Understaffing**. The high volume of paper generated by the system exceeds the capacity of the under-staffed customs offices, and produces a "high level of administrative error." *Id.* § 3.4.2.

Accordingly, delays in processing and returning paperwork, *id.* § 3.3.2.2, inadequate statistics concerning the actual volume of trade processed, *id.* § 3.3.3.1, large-scale personnel cuts, *id.* § 7.1.1, and an ineffective inquiry process all contribute to the smuggling problems of the EC. In short, the acknowledged political inaction of the EC and its Member States has contributed to the smuggling of goods.

2. The EC's and Member States' Own Actions and Inaction Have Created a Failing Transit System that Induces Smuggling

As the EC Parliamentary Committee has acknowledged, the problem of smuggling results in substantial part from broad economic and political policies of the EC itself and of its Member States. In the 1997 *EC Parliamentary Report*, the Parliamentary

Committee proposed specific solutions to the rising fraud. Of primary importance, the Parliamentary Committee proposed computerization of the customs control system thereby allowing customs officials to monitor goods during their journey through the EC. *See id.* § 17.6.1. The Committee further proposed that customs officials restrict routes, and establish a common policy on physical checks. *Id*. § 17.4.1. In making these recommendations, however, the Parliamentary Committee recognized that "[r]eform of [the] transit [system] imposes not only technical and legal reforms but distinct political decisions and action." *Id*. § 16.6.1.

From the government perspective, according to the *EC Parliamentary Report*, political considerations have to be balanced against competing law enforcement and local economic objectives in determining whether to implement such recommendations:

- **Increased costs to local economy**. Stricter controls could have the effect of raising costs for important segments of the economy such as the transport section.
- **New burden on taxpayers.** The regulated operating conditions of the official economy make it difficult for that economy to compete with the underground economy. To the extent that losses in tax revenue are sought to be recouped by extra tax collection, even greater burdens would be imposed on the legitimate sector.
- **Effect on external trade**. The extra costs imposed on EC business, whether from transit fraud or counter-measures to combat it (such as the 100% guarantee), would discourage external trade from which the EC receives other benefits.
- **Impact on local communities.** Entire communities have become dependent on the underground economy, having been excluded from regular social and employment circles.

Id. §§ 4.2.3, 4.2.4. These decisions can be made only at the political level of government, by the Member States and the EC.

In the intervening four years since these recommendations were made, the EC and the Member States effectively have failed to implement many of the proposed reforms. (Wilmott Decl. ¶ 26.) For example, despite a 1998 completion date, the transit system has not been computerized. (*Id.* ¶ 18.) This inaction is hardly surprising. The problems of transit fraud have taken on excessively political overtones, making any pan-European consensus on these issues nearly impossible. (*Id*. ¶¶ 21, 24, 27.) As noted above, reforming the transit system, or even enforcing the current rules, has local social and economic costs. (*Id.* ¶¶ 17-26.) For example, a strong policy of enforcing the guarantee can bankrupt the local transport industry. (*Id.* ¶ 22.) Moreover, each Member State has a different history, culture and attitude towards smuggling. (*Id.* ¶ 26.) The Member States are "neither inclined . . . to tighten the regulatory framework of the customs system nor do they appear willing to commit the necessary resources to the collection of customs duties." Own Resources Report § 1.2.2, at 10. No American court should entangle itself in those political questions. Therefore, the Complaint should be dismissed in its entirety as non-justiciable.

3. The Nature of These Political Questions and the Difficulty in Obtaining Adequate Information to Resolve Them Also Require Dismissal of the Complaint

American courts have dismissed cases, like the one before this Court, that raise foreign political questions, noting that "[d]ifficulty in obtaining access to relevant information also has been viewed by the Supreme Court as a basis upon which to apply the political question doctrine and decline to adjudicate the merits of an issue." *Linder*, 747 F. Supp. at 1464. "A limitation on access to relevant information is a particularly

serious impediment to the adjudication of issues touching on foreign relations." *Id.* at 1465.

Those same considerations require dismissal of the EC's case. To assess the customs controls of each Member State, Philip Morris will have to gather a large amount of information, through documents and depositions in fifteen European nations. Clearly, the vast majority of the relevant information is within the control of the Member States, none of which is presently a named party. For example, Philip Morris will seek discovery on such subjects as the measures the Member States and the EC have taken to detect and prevent smuggling, the customs policies and practices of each State, and the reasons underlying the decisions to enforce (or not to enforce) such policies.

The difficulty in obtaining discovery from the absent Member States on these and other important issues, at best, counsels against exercising jurisdiction here, and at worst, would prevent Philip Morris from putting on its defense, thereby violating Philip Morris' due process rights. *See, e.g., Sharon v. Time, Inc.*, 599 F. Supp. 538, 550-51 (S.D.N.Y. 1984) ("Even if the lack of evidence fails to establish a violation of due process, the fact that sensitive or secret material is central to the case and is unavailable must also be weighed in considering abstention"); *see also Linder*, 747 F. Supp. at 1466 ("When a court finds itself without judicially manageable standards to determine the merits of a claim, the additional problems attendant to the information gathering process further discourage setting about so difficult a task."). Given the multitude of political questions raised by this Complaint and the inability of this Court to resolve them, the Court must dismiss the claims as not justiciable.

VI. COMITY COMPELS THE DISMISSAL OF THIS SUIT

Regardless of whether plaintiff's claims could be cognizable before a United States court – and they clearly are not – this Court should dismiss the Complaint as a matter of comity. In the international context, "[c]omity . . . is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens . . . ." *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1895); *see also Finanz AG Zurich v. Banco Economico S.A.*, 192 F.3d 240, 246 (2d Cir. 1999). "Many federal courts have dismissed cases solely on the basis of comity." *Fleeger v. Clarkson Co.*, 86 F.R.D. 388, 392 (N.D. Tex. 1980) (citing *Cornfeld v. Investors Overseas Servs., Ltd.*, 471 F. Supp. 1255 (S.D.N.Y. 1979)); *see also Giro v. Banco Espanol de Credito, S.A.*, No. 98 Civ. 6195, 1999 WL 440462 (S.D.N.Y. June 28, 1999) (dismissing RICO action involving conduct occurring and effects felt principally in Spain because international comity counseled in favor of deferring to judicial system of foreign sovereign to resolve dispute), *aff'd*, 208 F.2d 203 (2d Cir. 2000). They have done so as a matter of "deference to the foreign country's legal, judicial, legislative, and administrative system of handling disputes over which it has jurisdiction, in a spirit of international cooperation." *Fleeger*, 86 F.R.D. at 392. Dismissal based on comity is warranted here.

This action has been brought by only the EC, not by the fifteen Member States, which have responsibility for collecting customs duties and VAT. The Member States are both capable of and responsible for enforcing their own laws and have established their own procedures and judicial systems for handling these matters. While it is unclear whether the filing of this suit by the EC in the United States indicates that the EC has a

different view than the Member States or is an attempt by the EC to supplant the Member States' responsibilities in this area, there is no reason for this Court to resolve these issues between the EC and the Member States by deciding this case in place of their own institutions and courts, and in the absence of all of the Member States as parties. Abstention is justified because the Member States' courts are far more familiar with the complexities of their own customs and tax laws than any American court would be, and the involvement of U.S. courts creates the unnecessary risk of misconstruing and disrupting the foreign tax enforcement schemes. Federal courts routinely abstain in disputes concerning the tax systems of individual American states, and the Member States should be similarly treated.

This Court also should dismiss this action in deference to proceedings now pending before the EC's Court of First Instance. That proceeding concerns fundamental issues involving some of the same parties and many of the issues in this case. The EC proceedings involve issues relating to the authority of the EC under the relevant EC Treaties to file this lawsuit, whether the Member States delegated to the EC the sovereign authority to enforce Member State revenue laws, whether any such authority includes the power to do so in non-Member State courts, and whether the procedural requirements for exercising any such authority were followed. Since the EC has never before attempted to exercise this type of sovereign authority, these proceedings raise novel and significant issues of EC law. In light of these issues, this Court should dismiss this suit.

A. The Court Should Abstain from Exercising Jurisdiction Over This Dispute in Deference to the Existing Tax Collection and Enforcement Procedures of the Member States

This Court should abstain from deciding the issues raised in the Complaint because they more properly belong before foreign courts or administrative tribunals.[28] Abstention is particularly appropriate when a federal court is asked to construe another state's tax law. As the Supreme Court has noted: "The special reasons justifying the policy of federal non-interference with state tax collection are obvious. The procedures for mass assessment and collection of state taxes and for administration and adjudication of taxpayers' disputes with tax officials are generally complex and necessarily designed to operate according to established rules." *Fair Assessment in Real Estate Assoc., Inc. v. McNary*, 454 U.S. 100, 108 n.6 (1981) ("[Q]uestions of state tax law . . . are more properly heard in state courts.").

The same considerations require the dismissal of the EC's claims here. In establishing customs duties, VAT and the "own resources" system, the EC and its Member States established a comprehensive regulatory scheme. Specifically, Member State laws and the EC Treaty, together with the Own Resources Decision, and the Own Resources Regulation, delineate the process by which tax deficiencies are raised and adjudicated: such claims are adjudicated in the Member States, according to the procedures and regulations implemented under national law. Own Resources Regulation,

[28] Federal courts routinely suspend their proceedings and defer to a federal administrative body issues raised by a claim when a regulatory scheme has placed those issues within the special competence of that administrative body. *United States v. Western Pac. R.R.*, 352 U.S. 59, 64 (1956); *County of Suffolk v. Long Island*, 907 F.2d 1295, 1309 (2d Cir. 1990). Similarly, federal courts dismiss complaints that would require the U.S. courts to interfere unduly with specialized, ongoing state regulatory schemes. *See United Mine Workers of Am. v. Gibbs*, 383 U.S. 715, 726 (1966) ("Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law.").

art. 4, 2000 O.J. (L 130) 3. A RICO lawsuit filed in an American court is not part of that process. In deference to that process, this case should be dismissed.

B. The Court Should Abstain from Exercising Jurisdiction Over This Dispute in Deference to the Ongoing Proceedings in the Court of First Instance of the EC

Threshold issues concerning the authority of the EC under European law to bring this lawsuit are pending before the EC's Court of First Instance. This Court should dismiss this action so that the EC's own courts can definitively answer these questions. "Courts have the inherent power to stay or dismiss an action based on the pendency of a related proceeding in a foreign jurisdiction." *Dragon Capital Partners v. Merrill Lynch Capital Servs.*, 949 F. Supp. 1123, 1127 (S.D.N.Y. 1997). In similar circumstances, district courts in this Circuit have abstained in deference to foreign proceedings. *See, e.g., Evergreen Marine Corp. v. Welgrow Int'l, Inc.*, 954 F. Supp. 101, 104 (S.D.N.Y. 1997) (abstaining in favor of suit in Belgium); *Dragon Capital*, 949 F. Supp. at 1127-30 (abstaining in favor of suit in Hong Kong); *Advantage Int'l Mgmt., Inc. v. Martinez*, No. 93 Civ. 6227, 1994 WL 482114 (S.D.N.Y. Sept. 7, 1994) (abstaining in favor of suit in Spain); *Caspian Inv. Ltd. v. Viacom Holdings*, 770 F. Supp. 880, 883-85 (S.D.N.Y. 1991) (abstaining in favor of suit in Ireland); *Continental Time Corp. v. Swiss Credit Bank*, 543 F. Supp. 408, 410 (S.D.N.Y. 1982) (abstaining in favor of suit in Switzerland); *see also Posner v. Essex Ins. Co.*, 178 F.3d 1209, 1223-24 (11th Cir. 1993) (upholding abstention in favor of suit in Bermuda).[29]

[29] Given the numerous deficiencies in this Complaint, identified in this motion and in the defendants' RICO 12(b)(6) Motion to Dismiss, dismissal is justified in this case. In some international abstention cases, courts have, as an alternative to dismissal, stayed the proceedings before them until the foreign suit is decided. Such a stay is unwarranted here because there is a lack of subject matter jurisdiction. In the event

(footnote continued on next page)

The matter before the Court of First Instance involves essentially the same parties and threshold questions concerning the authority under European law of the EC to file its lawsuit in the United States. These are questions that logically should be resolved before considering the EC's ability to satisfy American law requirements of standing and justiciability, and before delving into whether the EC can state a claim for relief under RICO. It would be inefficient if both the Court of First Instance and this Court were to delve into these issues at the same time, and it makes sense that the case within the EC's own court system resolve these questions of EC law. Not only are questions of EC law within the specific expertise of that tribunal, but also that tribunal can provide and enforce a definitive resolution of these issues. Accordingly, the Court should dismiss this action.

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that this Court declines to dismiss this case, however, a stay would be preferable to allowing the parallel proceedings to continue.

CONCLUSION

For each and all of the reasons set forth above, the EC's Complaint should be dismissed in its entirety for lack of subject matter jurisdiction and failure to join indispensable parties.

Dated: January 29, 2001

Respectfully submitted,

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